S. HRG. 100-715

THRIFT CHARTER ENHANCEMENT ACT OF 1988

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

S. 2073

Entitled the "Thrift Charter Enhancement Act of 1988"

TO PROVIDE FOR THE ENHANCEMENT OF THE VALUE OF THRIFT INSTITUTION CHARTERS BY CREATING INCENTIVES TO INVESTORS TO PLACE ADDITIONAL PRIVATE CAPITAL IN THE NATION'S THRIFT INDUSTRY

APRIL 27, 1988

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

84-991 WASHINGTON : 1988

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S241-31

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WILLIAM PROXMIRE, Wisconsin, *Chairman*

ALAN CRANSTON, California
DONALD W. RIEGLE, JR., Michigan
PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
ALAN J. DIXON, Illinois
JIM SASSER, Tennessee
TERRY SANFORD, North Carolina
RICHARD SHELBY, Alabama
BOB GRAHAM, Florida
TIMOTHY E. WIRTH, Colorado

JAKE GARN, Utah
JOHN HEINZ, Pennsylvania
WILLIAM L. ARMSTRONG, Colorado
ALFONSE M. D'AMATO, New York
CHIC HECHT, Nevada
PHIL GRAMM, Texas
CHRISTOPHER S. BOND, Missouri
JOHN H. CHAFEE, Rhode Island
DAVID K. KARNES, Nebraska

KENNETH A. MCLEAN, *Staff Director*
LAMAR SMITH, *Republican Staff Director and Economist*
PATRICK A. MULLOY, *General Counsel*
RICHARD S. CARNELL, *Counsel*
GILLIAN GARCIA, *Director of an Economic Analysis Group, GAO*

CONTENTS

WEDNESDAY, APRIL 27, 1988

	Page
Opening statement of Chairman Proxmire	1
Opening statements of:	
Senator Garn	2
Senator D'Amato	3
Senator Karnes	4
Prepared statement	6
Senator Heinz	24
Senator Sasser	26
Senator Cranston	43
Senate bill S. 2073	11

WITNESSES

Charles O. Sethness, Assistant Secretary for Domestic Finance, U.S. Department of the Treasury	28
New incentives for the thrift industry	28
Recapitalization of FSLIC	28
Thrift charter enhancement	29
Prepared statement	30
M. Danny Wall, Chairman, Federal Home Loan Bank Board	35
Status of the thrift industry	35
Deregulation	36
Response to oral questions of the committee	100
Panel discussion:	
Banking and commerce	39
Possible attraction of new capital	41
Long term solution	44
Liquidation of Freddie Mac	47
Theo H. Pitt, Jr., Chairman, U.S. League of Savings Institutions	48
Commercial lending authority	48
Prepared statement	51
Response to written questions of Senator Chafee	84
J.R. Nunn, President, Independent Bankers Association of America	55
Opposition to sections of bill	55
Prepared statement	58
John Koch, First Vice Chairman, National Council of Savings Institutions	61
Support for S. 2073	61
Conflict of interest regulations	62
Prepared statement	65
Response to written questions of Senator Chafee	88
Response to written questions of Senator Proxmire	87
William A. Cooper, Director, Association of Thrift Holding Companies	73
Eliminate regulatory restraints	73
Prepared statement	75
Response to written questions of Senator Chafee	90
Panel discussion:	
Gambling at the public's expense	78
Reason for savings and loan industry	82

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Mortgage Bankers Association of America, comments on S. 2073 from Warren Lasko, Executive Vice President	93
The Washington Post, Sunday, March 6, 1988, column entitled "Insolvent S&L's"	99

THRIFT CHARTER ENHANCEMENT ACT OF 1988

WEDNESDAY, APRIL 27, 1988

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:20 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Cranston, Sasser, Graham, Garn, Heinz, D'Amato, Hecht, Bond, Chafee, and Karnes.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

I apologize for my tardiness, Mr. Sethness and Senator Garn. I had to give a statement on the floor.

This is a time of serious problems for the thrift industry and the Federal Savings and Loan Insurance Corporation. At the end of last year, 506 thrifts—that's 16 percent of the industry—were insolvent under generally accepted accounting principles but still open for business. Most of those thrifts were losing money, and many were losing it hand over fist. Resolving these problem cases will be costly: Chairman Wall of the Bank Board estimates the ultimate cost to FSLIC at $15 billion; some other observers place it at $30 billion or even $70 billion.

Our hearing today is on S. 2073, the Thrift Charter Enhancement Act of 1988. I want to note at the outset that I have some concerns about the bill. The whole rationale for having a separate thrift industry is the thrift industry's role in housing finance. That's why thrift institutions are not subject to the same regulation as commercial banks. The Congress reaffirmed that principle last year in the Competitive Equality Banking Act by adopting the qualified thrift lender [QTL] test, which measures how much of a thrift institution's assets are devoted to housing finance. This bill would weaken the QTL test, broaden the commercial lending authority of thrift institutions, loosen other activity restrictions, and make thrifts even more like commercial banks. Yet if a thrift met the weakened QTL test, any company—any company—could own the thrift, without being subject to any restrictions on its activities. I'm concerned that the result would be a new, turbocharged version of the nonbank bank loophole, which we closed only last year.

I'm also concerned about the potential risks that would be posed by increasing the direct investment authority of thrift institutions, especially at a time when so many thrifts are still undercapitalized and when the Federal Home Loan Bank Board is having to focus

its supervisory resources on dealing with the weakest and worst-managed institutions. I want to make sure we don't end up making FSLIC's problems even worse than they are.

Yesterday, the Appropriations Committee's Subcommittee on HUD and the Independent Agencies, on which Senator Garn and I both serve and of which I'm chairman, heard from Chairman Wall of the Federal Home Loan Bank Board. I think that Mr. Wall and his colleagues have done a superb job under the most trying circumstances, and I certainly don't want to make that any more difficult for them than it already is. I think we all have to be concerned about the serious prospects of the thrift industry's problems becoming even worse.

Senator Garn.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman.

This hearing is a prelude to the hearings next month on the problems of the thrift industry. We are all very well aware the thrift industry today is facing some very difficult times. Due to the problems of the energy and agricultural sectors of our economy, savings associations in the Southwest and Midwest have been subjected to severe stresses. The Federal Home Loan Bank Board estimates that the cost of closing insolvent institutions in Texas alone may run as high as $6 to $7 billion. Estimates for restoring the entire system to health are considerably higher than that.

As I've stated before, I believe that an independent and healthy thrift industry has served our country very well. Congress should explore every possible option for restoring the industry to health.

Last year Congress did take the first step by providing an additional $10.8 billion to FSLIC for use in providing assistance to ailing thrift institutions or in closing hopelessly insolvent ones. That legislative action alone, however, is probably not enough. It may also be necessary to take additional steps designed to facilitate the sale of weak thrift institutions to financially strong buyers so that private sector capital will be brought into the industry.

Clearly, one way to accomplish this goal would be to make the thrift institution charter more attractive to potential buyers, subject of course to appropriate safety and soundness considerations. This would have the effect of enhancing the value of an ailing thrift so that it would be seen as a more desirable investment by another company. That is an approach that I took in 1986 in Title V of the banking bill I introduced, S. 2592.

Senator Karnes appears to be taking a similar approach with his own version of the Thrift Charter Enhancement Act. His bill would make substantial modifications to the current powers of federally chartered savings associations and relieve some of the current restrictions on savings and loan holding companies. The provisions are somewhat different from those in my 1986 bill, but the underlying concept should be considered, in my opinion, as the committee turns its attention to thrift industry problems in the hearings next month.

Some have argued that even under current law thrift institutions are not using existing charter powers to their fullest extent. That

argument, however, may miss the point. If the current powers of an ailing thrift institution are enhanced, that institution should become more valuable to a potential buyer, whether or not the ailing thrift would by itself want to or be able to engage in additional activities. As a result of enhancing the thrift charter, more potential buyers would be bidding for these failing institutions and the premium bid should also increase, thus saving the Federal Government, FSLIC, substantial sums.

In the light of the present problems facing the thrift industry, we should not overlook any potential solution or even partial solution which contributes to resolving the situation. I, therefore, commend Chairman Proxmire for holding this hearing and the hearings next month and I look forward to the comments of the witnesses at today's hearing.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn.

Senator D'Amato.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Thank you, Mr. Chairman.

Mr. Chairman, I'm pleased to be here and to welcome our witnesses this morning to discuss S. 2073, the Thrift Charter Enhancement Act, introduced by my good friend, Senator Karnes.

Senator Karnes himself certainly has a broad and deep background in the thrift industry, as a former chairman of the board of directors of the Federal Home Loan Bank Board in Topeka, KS, and as a former special counsel to the Federal Home Loan Bank Board, he can lay claim to being as knowledgeable as anyone on this committee regarding the savings and loan industry. So when he proposes an approach to the dire problems that the industry faces, it surely behooves us to listen carefully.

This bill certainly points out one of the central challenges we face in attempting to improve the situation, bolstering the capitalization of the Federal Savings and Loan Insurance Corporation, at the least burden possible to the taxpayers.

Now we tried to address this, as Senator Garn has indicated, in the FSLIC recapitalization component of the Competitive Equality Banking Act of 1987. We knew then, as we know now, that the amount authorized in that legislation was going to be insufficient. But the politics being what they were, we settled legislatively for what we realistically could achieve.

Mr. Chairman, I think while we certainly recognize the problems in the industry, I think we've got to be prudent as we move toward increasing powers. We don't want to exacerbate the present crisis. There has been, unfortunately, a number of examples where people I think have abused some of the powers that they have had. That's a fact when we look at it, whether it be the banks in California—it's been raised more than once that the kind of use of some of the investment techniques that this committee has raised questions about.

So I think, while I am deeply concerned and appreciative of the legislative efforts of my distinguished colleague, Senator Karnes, I

think we have to be prudent as we move in these steps to attempt to bring more capital into the thrift industry.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Karnes.

OPENING STATEMENT OF SENATOR KARNES

Senator KARNES. Thank you, Mr. Chairman.

This morning the committee will have the opportunity to hear testimony on a bill which I believe can address the important issue of attracting and retaining capital in our Nation's savings and loan industry.

I appreciate your efforts, Mr. Chairman, and those of Senator Garn, the ranking minority member of the committee, in scheduling these hearings and also I acknowledge the support and assistance of a cosponsor, Senator Bond, from Missouri on this bill as well.

A similar bill, H.R. 3906, has been introduced in the House of Representatives and as I stated in the course of the markup of the banking bill, I believe that we should look for opportunities to include the substance of S. 2073 in whatever separate thrift legislation Congress considers this session.

I also thank the witnesses who have agreed to appear today and offer their views to the committee on this bill. I know some of the witnesses have been given relatively short notice and I appreciate their responsiveness.

The various segments of the industry who have differing constituents and perspectives will be represented here today. It is also an important opportunity for the industry regulator and other interested agencies, such as the Department of Treasury, to express their concerns in a public forum.

I look forward to the statements of our witnesses today and the opportunity for members of the committee to explore those views with some questions.

Now I have a longstanding interest in the thrift industry and a continuing commitment to see that thrifts are there to serve an important and growing part of the housing as well as the lending markets. That is why I took the lead in the Senate in introducing this bill.

Mr. Chairman, I would like to point out an important characteristic of S. 2073. I have heard assertions that a consensus exists to the effect that the issues related to thrift powers should not be considered this year by Congress. I believe that there will be certain thrift legislation this year and this should be a part of it. There may be various reasons for such feelings. However, I believe that this bill does not challenge the consensus, but indeed adds to the support for a viable thrift industry.

The substance of S. 2073 deals with the powers of thrift holding companies rather than with the powers of savings and loan institutions whose deposits are insured by the FSLIC and which are subsidiaries of those holding companies. The primary focus of S. 2073 is capital. The purpose of the bill is to modify the legal and regulatory framework within the thrift institutions and thrift holding companies in which they operate.

I believe that we must take steps now that will serve to attract private equity and debt capital to the thrift industry. We must also encourage capital currently invested in the industry to maintain that capital position. The attraction of new capital to the industry is necessary if we are to minimize the potential call upon the resources of the FSLIC to support the deposits of those savings and loan institutions which are experiencing financial difficulties.

The acquisition of troubled thrift institutions will relieve the FSLIC of both the financial and the management burdens which it has found increasingly troublesome to manage. The most likely investors in troubled thrifts are healthy thrift holding companies who see resulting business opportunities in such transactions. We must be realistic and recognize that acquisitions of troubled thrifts will take place only where adequate incentives exist. I believe S. 2073 includes provisions which are designed to provide those incentives.

Mr. Chairman, I have a more complete statement that I would like to have reflected in the record, but that completes my remarks at this point.

The CHAIRMAN. Without objection, that will be printed in full in the record.

[The complete prepared statement of Senator Karnes and a copy of the proposed bill S. 2073 follow:]

STATEMENT OF SENATOR DAVID KARNES

APRIL 27, 1988

Mr. Chairman, this morning the Committee will have the opportunity to hear testimony on a bill which I believe can address the important issue of attracting and retaining capital in our nation's savings and loans industry. I appreciate your efforts and those of Senator Garn, the ranking minority member of the Committee, in scheduling these hearings. A similar bill, H.R. 3906, has been introduced in the House of Representatives. As I stated in the course of the markup of the banking bill, I believe that we should look for opportunities to include the substance of S. 2073 in whatever thrift measure Congress ultimately considers this session for final passage.

I also thank the witnesses who have agreed to appear here today and offer their views to the Committee on this bill. The hearing process is an extremely useful method for gathering in one place the various segments of the industry who have differing constituents and perspectives. It is also an important opportunity for the industry regulator and other interested agencies, such as the Department of the Treasury, to express their support and concerns in a public forum. I look forward to the statements of our witnesses today and the opportunity for members of the Committee to explore those views with some questions.

Mr. Chairman, I have a long standing committment to the savings and loan industry. Through my experience at the Department of Housing and Urban Development and the Federal Home Loan Bank Board, I became familiar with the major issues facing the residential housing industry and the lenders that finance that important segment of our nation's economy. My direct involvement in the formative years of the Federal Home Loan Mortgage Corporation (Freddie Mac) gave me a unique perspective on some of the innovations in the industry, such as the secondary markets in residential housing loans. As Chairman of the Federal

Home Loan Bank of Topeka, Kansas, I had the chance to see many of those same issues from the industry side. In short, I have along standing interest in the thrift industry and a continuing committment to seeing that thrifts are there to serve an important and growing part of the lending markets. That is why I took the lead in the Senate in introducing this bill.

Mr. Chairman, I would like to point out an important characteristic of S. 2073. I have heard assertions that a consensus exits to the effect that issues related to thrift powers should not be considered this year by Congress. There may be various reasons for such feelings. However, I believe that this bill does not challenge any such consensus. The substance of S. 2073 deals with the powers of thrift holding companies, rather than the with the powers of savings and loan institutions whose deposits are insured by the Federal Savings and Loans Insurance Corporation and which are subsidiaries of those holding companies.

The primary focus of S. 2073 is capital. The purpose of the bill is to modify the legal and regulatory framework within which thrift institutions and thrift holding companies operate. I believe that we must take steps now that will serve to attract private equity and debt capital to the thrift industry. We must also encourage those currently invested in the industry to maintain their substantial capital positions.

The attraction of new capital to the industry is necessary if we are to minimize the potential call upon the resources of the FSLIC to support the deposits of those savings and loan institutions which are experiencing financial difficulties. The acquisition of troubled thrift institutions will relieve the FSLIC of both the financial and the management burdens which it has found increasingly difficult to manage. The most likely investors in troubled thrifts are healthy thrift holding companies who see resulting business opportunities in such transactions. We must be realistic and recognize that acquisitions of troubled thrifts will take place only where adequate incentives exist. S. 2073 includes provisions which are designed to provide those incentives.

We must also recognize that investors are constantly evaluating alternative areas and vehicles for business opportunities. Capital will move as a function of return and operating flexibility, and the competition for capital is intense. Thus, an enhanced operating environment is essential if we are to assure that those whose capital is committed to the savings and loan industry continue to believe that the opportunities for operating under a thrift charter outweigh investment possibilities elsewhere.

Before I highlight some of the specific provisions of the bill, I would point out an important condition that qualifies those situations in which additional legal and regulatory flexibility would be available. Most provisions of the bill are targeted at those thrift institutions which meet applicable capital requirements and do not present safety and soundness problems. Institutions which meet those standards would be able to take advantage of the provisions. I believe that this is an important point. In attempting to attract capital to the thrift industry, we must emphasize the need to maintain adequate capital levels and sound operating standards.

With that background, I would like to go briefly into some of the specifics of S. 2073. The bill contains provisions which would:

o allow thrift holding companies to hold a limited interest in the stocks of non-affiliated thrift institutions by permitting them to acquire up to five percent of the voting sock of non-affiliated thrifts.

o relax or eliminate unnecessarily strict limitations on thrift and thrift holding company operational activity, including current limitations on affiliate transaction's restrictions on interlocking directorates with other financial institutions, and requirements for net worth maintenance agreements.

o eliminate the severe restrictions on debt issuance by non-diversified thrift holding companies.

o authorize Federal associations that acquire, or are affiliated with a holding company that acquires, a troubled thrift to invest an additional 5 percent of assets in service corporation subsidiaries.

o authorize a thrift holding company that acquires at least one troubled thrift to own two healthy thrifts and still not be subject to the activities restrictions placed on multiple savings and loan holding companies and their non-thrift affiliates by section 408(c) of the National Housing Act.

o authorize subsidiaries of a holding company that acquires, or a subsidiary of which acquires, a troubled thrift to engage in any transaction with a non-thrift affiliate authorized under sections 23A and 23B of the Federal Reserve Act, notwithstanding the standards of section 4(c)(8) of the Bank Holding Company Act.

o place outer limits on capital maintenance requirements which can be imposed on acquirers of troubled thrifts.

o eliminate discriminatory regulatory requirements on de novo or newly insured institutions once they have satisfactorily established and maintained a safe and sound record operating experience.

o allow federally chartered thrift institutions to invest in service corporation subsidiaries of the thrift, yet set the amount well below the levels that many State-chartered thrifts may undertake.

o allow federally chartered thrifts to invest a small portion of their assets in small business investment companies.

Mr. Chairman, I would close my remarks by simply saying that the time to act to make thrift charters more attractive is now. Recent articles in the Washington Post and The Wall Street Journal have reported on the current financial position of the FSLIC and the problems facing the insurance fund. Congress spoke on FSLIC funding last year and the feeling is that the agency should have the opportunity to work through that assistance package before revisiting issues related to the amount of resources which it has to work with.

However, this does not mean that Congress cannot do a number of significant things this year to enhance the position of the FSLIC. Aside from the issue of monetary resources is the problem of managing an increasing burden of troubled institutions and assets. Every troubled thrift that can be sold to investors means one less situation that the FSLIC must spend its limited and already strained management resources on. Those thrift holding companies and other investors who have been interested in acquiring troubled thrifts are those that traditionally have the management experience and sophistication to stop the hemorrhaging in those institutions. This is exactly what is needed. We mislead ourselves if we allow ourselves to believe that the problems will be easier tomorrow simply by virtue of the passage of time. Problems put off until tomorrow are merely bigger and, frequently, more unmanageable than they are today.

Mr. Chairman, I trust that the testimony that we will receive today will place on the table the need to bring private capital into the thrift industry and the best means for doing so. I believe that S. 2073 takes several large steps in that direction and is a needed piece of legislation. I hope that we will not let this year go by without taking responsible steps to deal with today's thrift industry problems.

Thank you Mr. Chairman.

100TH CONGRESS
2D SESSION

S. 2073

Entitled the "Thrift Charter Enhancement Act of 1988".

IN THE SENATE OF THE UNITED STATES

FEBRUARY 18 (legislative day, FEBRUARY 15), 1988

Mr. KARNES introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

Entitled the "Thrift Charter Enhancement Act of 1988".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. (a) SHORT TITLE.—This Act may be cited as the "Thrift Charter Enhancement Act of 1988".

TITLE I—AMENDMENTS AFFECTING FEDERALLY CHARTERED AND DE NOVO ASSOCIATIONS

SEC. 101. COMMERCIAL LENDING AUTHORITY.—Section 5(c)(1)(R) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(c)(1)(R)) is amended by adding at the end thereof ", except that the aggregate amount of loans under this paragraph made by a savings and loan association or savings

bank that has maintained capital for three of the four preceding calendar quarters at a level equal to or greater than that required under the regulations of the Federal Home Loan Bank Board shall not exceed 20 per centum of assets.".

SEC. 102. INVESTMENT IN SERVICE CORPORATIONS BY FEDERALLY CHARTERED SAVINGS AND LOAN ASSOCIATIONS.—Section 5(c)(4)(B) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(c)(4)(B)) is amended to read as follows:

"(B) SERVICE CORPORATIONS.—Investments in the capital stock, obligations, or other securities of any corporation organized under the laws of the State in which the home office of the association is located, if the entire capital stock of such corporation is available for purchase only by savings and loan associations of such State and by Federal associations having their home offices in such State. Investments under this subparagraph may not exceed 4 per centum of assets, except that an additional 1 per centum of assets may be invested under this subparagraph in investments primarily for community, inner city or community development purposes, and except that an additional 5 per centum of assets may be invested under this subparagraph by a Federal association that has acquired, or the affiliate of which has acquired, an insured institu-

tion pursuant to an acquisition under section 408(m) or section 406(f) of the National Housing Act. As used in this subparagraph the term 'affiliate' shall have the same meaning as in section 408(a)(1)(I) of the National Housing Act.".

SEC. 103. INVESTMENT IN SMALL BUSINESS INVESTMENT COMPANIES.—Section 5(c)(4)(D) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(c)(4)(D)) is amended to read as follows:

"(D) SMALL BUSINESS INVESTMENT COMPANIES.—An association may invest in stock, obligations, or other securities of any small business investment company organized pursuant to the Small Business Act of 1958 (15 U.S.C. 681 et seq.): *Provided* That the aggregate amount of such investments shall not exceed the greater of 1 per centum of the association's assets of 5 per centum of its capital and surplus.".

SEC. 104. DE NOVO INSTITUTIONS.—Section 403 of the National Housing Act (12 U.S.C. 1726) is amended by adding a new paragraph at the end thereof as follows:

"(f) DE NOVO INSTITUTIONS.—Following the completion of the initial three years of insured operation substantially in accordance with all material requirements of the Corporation, a de novo or other newly insured institution shall cease to be subject to requirements based on its de novo or

newly insured status and shall be subject to the laws, regulations, and policies governing insured institutions in the same manner as all other insured institutions.".

TITLE II—AMENDMENTS AFFECTING REGULATION OF SAVINGS AND LOAN HOLDING COMPANIES

SEC. 201. DEFINITION OF AFFILIATE.—Section 408(a)(1)(H) of the National Housing Act (12 U.S.C. 1730a(a)(1)(H)) is amended to read as follows:

"(H) 'Subsidiary' of a person means any company which is controlled by such person, or by a company which is a subsidiary of such person by virtue of this subsection (except that for purposes of paragraphs (1), (2), (4), and (6) of subsection (c) of this section, the term 'subsidiary' does not include a service corporation subsidiary of an insured institution or any subsidiary of such service corporation).".

SEC. 202. UNITARY HOLDING COMPANY TREATMENT.—Section 408(c)(3)(B) of the National Housing Act (12 U.S.C. 1730a(c)(3)(B)) is amended to read as follows:

"(B) more than 1 insured institution, if—

"(i) at least 1 of the insured institution subsidiaries of such company was acquired pursuant to an acquisition under subsection (m) of this section or section 406(f);

"(ii) no more than 2 of the insured institution subsidiaries of such company were acquired or established other than pursuant to an acquisition under subsection (m) of this section or section 406(f); and

"(iii) all of the insured institution subsidiaries of such company are qualified thrift lenders (as determined under subsection (o))."

SEC. 203. AFFILIATE TRANSACTIONS.—Sections 408(d)(6) (A), (B), and (C) of the National Housing Act (12 U.S.C. 1730a(d)(6) (A), (B), and (C)) are amended by removing the phrase "the lesser of" as it appears in each section and placing in lieu thereof the phrase "the greater of."

SEC. 204. ACTIVITIES OF SAVINGS AND LOAN HOLDING COMPANIES.—Section 408(e)(1)(A)(iii) of the National Housing Act (12 U.S.C. 1730a(e)(1)(A)(iii)) is amended to read as follows:

"(iii) to acquire by purchase or otherwise more than 5 per centum of the voting shares of an insured institution not a subsidiary, or of a savings and loan holding company not a subsidiary, or in the case of a multiple savings and loan holding company, to so acquire or retain more than 5 per centum of the voting shares of any company not a subsidiary which is engaged in any business

activity other than those specified in paragraph (2) of subsection (c) of this section, except that, notwithstanding any other provision of law, the foregoing shall not prohibit a subsidiary investment banking firm, or broker-dealer in securities, of a savings and loan holding company, from engaging in underwriting, trading, secondary market transactions, or other customary securities activities with respect to voting shares of an insured institution, or savings and loan holding company, which is not a subsidiary of such a savings and loan holding company; or".

SEC. 205. INTERLOCKING DIRECTORS OF SAVINGS AND LOAN HOLDING COMPANIES.—Section 408(i) of the National Housing Act (12 U.S.C. 1730a(i)) is amended:

(1) by adding "or" at the end of paragraph (1);

(2) by striking out paragraph (2); and

(3) by redesignating paragraph (3) as paragraph (2).

SEC. 206. AMENDMENTS TO QUALIFIED LENDER TEST.—Section 408(o) of the National Housing Act (12 U.S.C. 1730a(o)) is amended:

(a) in paragraph (5)(B)(iii) thereof by striking the paragraph and inserting in lieu thereof "(iii) liquid assets held by the institution or subsidiary, which shall

include assets of the type required to be maintained under section 5A of the Federal Home Loan Bank Act or other assets rated investment grade held for the purposes of both (1) increasing the liquidity of the asset portfolio, and (2) protecting against the interest rate risk inherent in holding home mortgages; and";

(b) in paragraph (5)(B)(iv) thereof by striking "50 per centum of";

(c) in paragraph (6) thereof by striking "clauses (iii) and (iv)" and substituting in lieu thereof "clause (iv)";

(d) in paragraphs (1)(A) and (1)(B) thereof by striking "60 per centum" and inserting in lieu thereof "the required qualified thrift investment percentage";

(e) in paragraph (2)(B) thereof by striking "60" and inserting in lieu thereof "50";

(f) in paragraph (5) thereof by inserting a new subparagraph (C) to read as follows:

"(C) REQUIRED QUALIFIED THRIFT INVESTMENT PERCENTAGE.—The term 'required qualified thrift investment percentage' means 60 per centum in 1988, 55 per centum in 1989, and 50 per centum in 1990 and all years thereafter.".

SEC. 207. GROSS MARKETING PRACTICES OF SAVINGS AND LOAN HOLDING COMPANIES.—Section 408(p) of

the National Housing Act (12 U.S.C. 1730a(p)) is amended by—

(a) striking paragraph (2) thereof;

(b) striking "(1) TRANSACTIONS WITH CERTAIN AFFILIATES.—";

(c) redesignating subparagraphs "(A)" and "(B)" as paragraphs "(1)" and "(2)", respectively; and

(d) by designating clauses "(i) and (ii)" of subparagraph (A) as subparagraphs "(A)" and "(B)", respectively, of new subsection (p)(1) as amended by this section.

SEC. 208. INVESTMENT ACTIVITY OF CERTAIN AFFILIATES.—The first clause of section 408(p)(1)(A) of the National Housing Act (12 U.S.C. 1730a(p)(1)(A)) is amended to read as follows:

"(A) IN GENERAL.—Transactions between any insured institution subsidiary of a savings and loan holding company and any affiliate (of such insured institution subsidiary) which is engaged only in business activities described in subsection (c)(2)(F)(i) and transactions between any insured institution subsidiary of a savings and loan holding company and any affiliate (of such insured institution subsidiary) where either the insured institution subsidiary or any one of its affiliates

has acquired an insured institution pursuant to an acquisition under section 408(m) or section 406(f)—".

SEC. 209. AMENDMENT TO POWERS OF MUTUAL HOLDING COMPANIES.—Section 408(s) of the National Housing Act (12 U.S.C. 1730a(s) is redesignated as section 408(r) and is amended:

(a) in paragraph (5)(B) by adding the words "or stock" after "mutual"; and

(b) by redesignating paragraphs "(7)" and "(8)" as paragraphs "(8)" and "(9)", respectively, and by inserting a new paragraph (7) as follows:

"(7) COMMON STOCK.—A mutual institution that is a subsidiary of a mutual holding company shall have the power subject to regulations of the Corporation to issue to persons other than its parent holding company, an amount of common stock and securities convertible into common stock which in the aggregate does not exceed 49 per centum of the issued and outstanding stock of the institution. For purposes of this 49 per centum limitation, outstanding securities that are convertible into common stock shall be considered as issued and outstanding common stock.".

SEC. 210. DEBT APPROVAL.—Section 408(g) of the National Housing Act (12 U.S.C. 1730a(g)) is repealed, and subsections "(h)" through "(t)" are redesignated as subsections "(g)" through "(s)", respectively.

SEC. 211. NET WORTH MAINTENANCE.—At the end of section 408 of the National Housing Act (12 U.S.C. 1730a) add a new subsection (t) to read as follows:

"(t) NET WORTH MAINTENANCE.—After the date of enactment of this subsection the Corporation may not require, as a condition to the acquisition by any savings and loan holding company of a subsidiary insured institution, the execution by such holding company of an agreement to guarantee for a period greater than three years the maintenance of the reserves or other capital of such subsidiary at a specified level, and all such agreements executed prior to such date of enactment shall terminate and shall have no further force or effect three years after the date of execution of such agreement: *Provided, however,* That if within sixty days of the end of such three year period during which an agreement has been in operation the Corporation finds either that the subsidiary has not been in compliance throughout three of the four preceding fiscal quarters with the reserve requirements established under section 403(b) of this Act and all other capital requirements of the Corporation, or that in the opinion of the Corporation the subsidiary is engaging in unsafe or unsound practices, the Corporation may require such agreement to continue in operation beyond three years until compliance by such subsidiary throughout three of four fiscal quarters is achieved and all unsafe or unsound practices have ceased.".

SEC. 212. TRANSACTIONS WITH AFFILIATED PERSONS.—Section 407 of the National Housing Act (12 U.S.C. 1730) is amended by adding at the end thereof the following new subsection:

"(u) TRANSACTIONS WITH AFFILIATED PERSONS.—The Corporation shall revise its rules and regulations relating to loans and other transactions between an insured institution and its executive officers, directors, insiders and other affiliated persons, to be consistent with rules and regulations relating to such transactions developed by the Federal banking agencies.".

TITLE III—AMENDMENTS TO THE DEPOSITORY INSTITUTIONS MANAGEMENT INTERLOCKS ACT

SEC. 301. EXEMPTIONS.—Section 205 of the Depository Institutions Management Interlocks Act (12 U.S.C. 3204) is amended by adding the following new subsections (7) and (8) to read as follows:

"(7) A company that becomes a depository holding company by acquiring an insured institution pursuant to section 408(m) of the National Housing Act (12 U.S.C. 1730a(m)).

"(8) Any depository institution, depository holding company or affiliate thereof, unless the Federal regulator of such institution or holding company, as set out

in section 207, determines within sixty days after notice that the interlocking services of a management official with a nonaffiliated depository institution, depository holding company or affiliate thereof would result in a monopoly or substantial lessening of competition, or would lead to substantial conflicts of interest, or if the Federal regulator of the nonaffiliated entity, if different from the Federal regulator of the notifying entity, makes a similar determination.".

The CHAIRMAN. Senator Heinz.

Senator HEINZ. Mr. Chairman, I ask unanimous consent to put my statement in the record.

The CHAIRMAN. Without objection, so ordered. I also have a statement from Senator Sasser for the record.

[The complete prepared statement of Senators Heinz and Sasser follow:]

STATEMENT OF THE HONORABLE JOHN HEINZ
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
APRIL 27, 1988

MR. CHAIRMAN, I JOIN YOU IN WELCOMING OUR DISTINGUISHED WITNESSES TODAY AS THIS COMMITTEE EXAMINES S. 2073, THE THRIFT CHARTER ENHANCEMENT ACT OF 1988, INTRODUCED BY OUR COLLEAGUE, SENATOR KARNES.

IN 1982, PRESIDENT REAGAN SIGNED THE GARN-ST GERMAIN DEPOSITORY INSTITUTIONS ACT. THAT ACT WAS THE PRODUCT OF A GROWING CRISIS IN THE THRIFT INDUSTRY -- THE ASSET/LIABILITY MISMATCH BROUGHT ON BY SPIRALING INTEREST RATES AND LONG-TERM FIXED RATE MORTGAGE PORTFOLIOS. THAT LANDMARK LEGISLATION ALLOWED THRIFTS TO DIVERSIFY THEIR LENDING OPERATIONS SO THAT THEY WOULD BE LESS SUSCEPTIBLE TO EARNINGS SLUMPS CAUSED BY THE LENDING LONG AND BORROWING SHORT SYNDROME.

MR. CHAIRMAN, FIVE YEARS LATER PRESIDENT REAGAN AGAIN SIGNED LEGISLATION THAT WAS DRIVEN BY ANOTHER CRISIS IN THE THRIFT INDUSTRY: THE BANKRUPTCY OF FSLIC.

THE KEY QUESTION IS WHAT PUT THE DRAIN ON THE FSLIC TO CAUSE IT TO GO "BELLY-UP"? SOME OF THE DRAIN CAME FROM DEAD AND DYING THRIFTS LOCATED IN THE SOUTHWEST WHERE DEPRESSED ENERGY AND REAL ESTATE MARKETS PLAYED A LARGE ROLE IN THE COLLAPSE OF MANY INSTITUTIONS. HOWEVER, A SUBSTANTIAL NUMBER OF S&L DEATHS WERE

DUE TO SELF-INFLICTED PROBLEMS WHICH STEMMED FROM ABUSES OF THE NEW AUTHORITIES GRANTED IN THE 1982 LEGISLATION.

MR. CHAIRMAN, NOT ONE YEAR AGO, CONGRESS VOTED FOR A $10.8 BILLION RECAPITALIZATION PLAN TO REVIVE THE INSURANCE FUND. YET, DESPITE THIS EFFORT, THE FSLIC WAS REPORTED TO HAVE BEEN $13 BILLION IN THE RED AT YEAR-END 1987. RECENT CALCULATIONS INDICATE FSLIC COULD NEED UP TO SIX TIMES AS MUCH MONEY AS PROVIDED FOR UNDER LAST YEARS'S RECAP BILL; THAT'S ANOTHER $60 BILLION ON TOP OF THE $10.8 WE'VE ALREADY APPROVED.

GIVEN THIS SCENARIO AND THE LONG TERM IMPLICATIONS ON OUR BANKING SYSTEM, I AM WARY ABOUT CONSIDERING FURTHER DEREGULATION OF THE THRIFT INDUSTRY AS THE LATEST MEANS TO RECAPITALIZE THE FSLIC. IF HINDSIGHT IS 20-20, I AM SOMEWHAT SKEPTICAL AS TO WHAT A FURTHER EXPANSION OF THRIFTS' COMMERCIAL LENDING AUTHORITY WILL PRODUCE. MORE IMPORTANTLY, I HAVE SERIOUS RESERVATIONS REGARDING MAKING IT EASIER FOR COMMERCIAL FIRMS TO OWN THRIFTS IN ORDER TO INJECT CAPITAL INTO THE INDUSTRY. THIS PRINCIPLE IS CONTRARY TO EVEN OUR MOST RECENT ACTION IN S.1886, WHERE WE STILL MAINTAIN A LINE BETWEEN FINANCIAL AND NONFINANCIAL ACTIVITIES.

MR. CHAIRMAN, THE FSLIC CRISIS IS STILL VERY REAL. IT STILL MUST BE SOLVED AND HOPEFULLY, NOT AT THE EXPENSE OF THE FDIC THROUGH A MERGER OR THE EXPENSE OF THE TAXPAYERS THROUGH A FEDERAL BAILOUT. I TRUST THAT THE WITNESSES WILL ADDRESS SOME OF MY CONCERNS AND I LOOK FORWARD TO THEIR TESTIMONY.

Jim Sasser

STATEMENT OF SENATOR JIM SASSER, SENATE BANKING COMMITTEE, APRIL 27, 1988

MR. CHAIRMAN, I AM PLEASED THAT THE COMMITTEE IS HOLDING A HEARING THIS MORNING TO CONSIDER LEGISLATION TO ENHANCE THE VALUE OF A THRIFT CHARTER. CERTAINLY, NO ONE CAN ARGUE THAT THE SAVINGS AND LOAN INDUSTRY IS IN SOME TROUBLE.

INDEED, WE SHOULD CONSIDER ALL POSSIBLE MEANS TO RESTORE THE THRIFTS TO THE HEALTHY, STRONG AND PROFITABLE STATE THEY ONCE OCCUPIED.

YET, THIS LEGISLATION, LIKE SO MANY BANKING BILLS, RAISES QUESTIONS ABOUT COMPETITIVE EQUITY AND RISK. THERE IS MUCH CONCERN THAT THE PROBLEMS THAT ARE BEARING DOWN ON THE THRIFT INDUSTRY TODAY ARE THE RESULT OF TOO MUCH DEREGULATION, TOO QUICKLY, WITH TOO LITTLE REGULATION.

MOREOVER, CREATING A PREFERRED STATUS FOR ONE TYPE OF INSTITUTION OVER ANOTHER TYPE CAN POTENTIALLY DESTABILIZE

COMPETITION AMONG ALL INSTITUTIONS OVER THE LONG RUN. ALTHOUGH I HAVE TO SAY -- ANYONE WHO DOESN'T THINK CONGRESS HAS CREATED SUCH INEQUITIES IN THE PAST IS PRETTY NAIVE.

MR. CHAIRMAN, I LOOK FORWARD TO HEARING FROM THE DISTINGUISHED WITNESSES THAT HAVE BEEN ASSEMBLED. I AM, AS I HAVE SAID, A VERY STRONG PROPONENT OF HEALTHY, INDEPENDENT THRIFT INDUSTRY. I AM OPEN TO ANY LEGISLATIVE SUGGESTIONS ON HOW TO MAINTAIN THAT SITUTATION. THANK YOU.

The CHAIRMAN. Mr. Sethness, you're the Assistant Secretary for Domestic Finance, U.S. Department of the Treasury. We're happy to have you, sir. Go right ahead.

STATEMENT OF CHARLES O. SETHNESS, ASSISTANT SECRETARY FOR DOMESTIC FINANCE, U.S. DEPARTMENT OF THE TREASURY

Mr. SETHNESS. Thank you.

Mr. Chairman, Senator Garn, members of the committee: thank you for the opportunity to testify before you today on S. 2073.

The CHAIRMAN. Mr. Sethness, before you proceed, let me say I hope that the witnesses can confine their oral remarks to 10 minutes and your statement will be printed in full in the record.

Mr. SETHNESS. This is a sharply edited copy, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Sethness.

Mr. SETHNESS. For some time now the Treasury Department has supported thrift charter enhancement as a means of attracting new capital into the industry, augmenting the profitability of capital already invested, and reducing the costs of resolving cases to the Federal Savings and Loan Insurance Corporation.

NEW INCENTIVES FOR THE THRIFT INDUSTRY

In fact, thrift charter enhancement has been one of the components of our three-pronged strategy for assisting the troubled thrift industry and shoring up the FSLIC. Permit me to refresh the committee's memory of that proposal. Our first prong called upon the Federal Home Loan Bank Board to create new incentives for the industry to increase its capital and, concurrently, to halt the growth of the industry's problems through increased supervision. Significant steps were taken in this direction when the Bank Board issued new regulations concerning capital and examinations beginning in the summer of 1986. More work continues in this area.

RECAPITALIZATION OF FSLIC

The second prong of our strategy consisted of a $15 billion recapitalization plan for the FSLIC. Although a recapitalization plan was enacted last August—after a long delay from our introduction of the proposal—the amount was reduced to $10 billion—net of the mandated return of FSLIC's secondary reserve—on the advice of some rather less than objective parties. Since then, the situation in the industry has at least not improved. It should be pointed out, however, that the thrift industry's recent losses stem largely from the realization of costs that Treasury, the Bank Board, the GAO, and many Members of Congress expected. That is, after all, why the recapitalization legislation was necessary and also why it was designed to expand or contract, depending upon what the situation warrants—with all of us having the clear recognition that the FSLIC cannot create commitments to honor—of whatever sort—that exceed its available resources over time. In addition, the industry's problems cannot be solved overnight, because there are capacity constraints on the amount of funds the FSLIC can utilize effectively.

THRIFT CHARTER ENHANCEMENT

This makes thrift charter enhancement—the final prong of our strategy—a vital means of expanding the capital base of the thrift industry and protecting depositors without dipping into the public coffers. In a 1986 legislative draft, Treasury proposed specific measures to enhance the thrift charter, many of which were eventually incorporated into the 1986 "Deposit Insurance Reform and Competitive Enhancement Act," which was introduced by Senator Garn. In general, we favor efforts that will attract outside capital while maintaining the safety and soundness of the industry and ensuring that to the extent that the powers of banks and thrifts become more similar, the regulation and supervision of the two industries are also made more similar. Thrift charter enhancement should not provide thrifts with bank-like powers and then subject those activities to less rigorous criteria in terms of capital, accounting, disclosure, supervision, et cetera. This could exacerbate instabilities in the financial services market, place banks at a competitive disadvantage vis-a-vis thrifts, and create undue risks.

In particular, we very much support the provisions in S. 2073 which repeal the cross-marketing restrictions on thrift holding companies that purchase failing thrifts; replace the FSLIC's "conflict of interests" regulations with those promulgated by the Federal bank regulators to make more uniform the regulation of banks and thrifts; and subject thrifts' affiliate transactions—including the purchase, sale, or lease of property or assets—to the "arm's length" restrictions applicable to commercial banks.

Charter enhancement legislation must not only serve as an incentive to attract needed, new capital into the thrift industry, from as broad a variety of sources as possible, but also be designed: (1) to reward only those thrifts which are well-capitalized, well-managed, and which meet the Bank Board's safety and soundness regulations; and (2) to make more uniform the regulation of thrifts, banks, and their respective holding companies in those cases where the activities of these entities are made more uniform.

Treasury supports most of the concepts proposed in S. 2073, but believes several changes are necessary to ensure that charter enhancement cannot be exploited by troubled thrifts and thereby expose the FSLIC to increased risk of loss. I have provided the committee with a detailed presentation of Treasury's positions on the various sections of S. 2073 in an appendix to my testimony.

In conclusion, at this point I want to reiterate Treasury's support for thrift charter enhancement, for a significant number of S. 2073's provisions, and for all of them if amended to reflect our concerns. Private solutions to the thrift industry's travails must be emphasized, especially when proposals for a taxpayer bailout are emanating from a number of quarters.

That concludes my prepared remarks, Mr. Chairman. I will be happy to answer any questions the members of the committee may have.

[The complete prepared statement of Mr. Sethness follows:]

84-991 0 - 88 - 2

TESTIMONY OF THE HONORABLE
CHARLES O. SETHNESS
ASSISTANT SECRETARY FOR DOMESTIC FINANCE
U.S. DEPARTMENT OF TREASURY
BEFORE THE SENATE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
APRIL 27, 1988

Mr. Chairman, Senator Garn, and Members of the Committee:

I thank you for the opportunity to testify before you today on S. 2073, the "Thrift Charter Enhancement Act of 1988," which was introduced by Senator Karnes. For some time now, the Treasury Department has supported thrift charter enhancement as a means of attracting new capital into the industry, augmenting the profitability of capital already invested, and reducing the costs of resolving cases to the Federal Savings and Loan Insurance Corporation (FSLIC).

In fact, thrift charter enhancement has been one of the components of our three-pronged strategy for assisting the troubled thrift industry and shoring up the FSLIC. Permit me to refresh the Committee's memory of that proposal. Our first prong called upon the Federal Home Loan Bank Board (Bank Board) to create new incentives for the industry to increase its capital and, concurrently, to halt the growth of the industry's problems through increased supervision. Significant steps were taken in this direction when the Bank Board issued new regulations concerning capital and examinations beginning in the summer of 1986. More work continues in this area.

The second prong of our strategy consisted of a $15 billion recapitalization plan for the FSLIC. Although a recapitalization plan was enacted last August -- after a long delay from our introduction of the proposal -- the amount was reduced to $10.0 billion net of the mandated return of FSLIC's secondary reserve on the advice of some rather less than objective parties. Since then, the situation in the industry has at least not improved. It should be pointed out, however, that the thrift industry's recent losses stem largely from the realization of costs that Treasury, the Bank Board, the General Accounting Office, and many members of Congress expected. That is, after all, why the recapitalization legislation was necessary and also why it was designed to expand or contract, depending upon what the situation warrants

-- with the clear recognition that the FSLIC cannot create commitments (of whatever sort) that exceed its available resources to honor over time. In addition, the industry's problems cannot be solved overnight, because there are capacity constraints on the amount of funds the FSLIC can utilize effectively.

This makes thrift charter enhancement -- the final prong of our strategy -- a vital means of expanding the capital base of the thrift industry and protecting depositors without dipping into the public coffers. In a 1986 legislative draft, Treasury proposed specific measures to enhance the thrift charter, many of which were eventually incorporated into the 1986 "Deposit Insurance Reform and Competitive Enhancement Act," which was introduced by Senator Garn. In general, we favor efforts that will attract outside capital while maintaining the safety and soundness of the industry and ensuring that to the extent that the powers of banks and thrifts become more similar, the regulation and supervision of the two industries are also made more similar. Thrift charter enhancement should not provide thrifts with bank-like powers and then subject those activities to less rigorous criteria in terms of capital, accounting, disclosure, supervision, etc. This could exacerbate instabilities in the financial services market, place banks at a competitive disadvantage vis-a-vis thrifts, and create undue risks.

In particular, we very much support the provisions in S. 2073 which repeal the cross marketing restrictions on thrift holding companies that purchase failing thrifts; replace the FSLIC's "conflict of interests" regulations with those promulgated by the federal bank regulators to make more uniform the regulation of banks and thrifts; and subject thrifts' affiliate transactions -- including the purchase, sale, or lease of property or assets -- to the "arm's length" restrictions applicable to commercial banks.

Charter enhancement legislation must not only serve as an incentive to attract needed, new capital into the thrift industry, from as broad a variety of sources as possible, but also be designed: (1) to reward only those thrifts which are well-capitalized, well-managed, and which meet the Bank Board's safety and soundness regulations; and (2) to make more uniform the regulation of thrifts, banks, and their respective holding companies in those cases where the activities of these entities are made more uniform.

The Karnes Bill (S. 2073)

Treasury supports most of the concepts proposed in S. 2073, but believes several changes are necessary to ensure that charter enhancement cannot be exploited by troubled thrifts and thereby expose the FSLIC to increased risk of loss. I have provided the Committee with a detailed presentation of Treasury's positions on the various sections of S. 2073 in an appendix to my testimony. At this time, however, I would like to comment briefly on several of the bill's more important provisions.

Additional Powers

S. 2073 would augment the powers of thrifts or thrift holding companies in several areas, either placing them on more of a par with banks or bank holding companies or simply enhancing authority unique to thrifts. For example, S. 2073 would permit federally chartered thrifts to increase their commercial loan limits from 10 to 20 percent of assets, provided they are in compliance with the Bank Board's capital requirements. We believe that thrifts that increase their commercial lending above the 10 percent threshold should also hold capital reserves in an amount equal to those held by banks. Such additional capital would help to offset any risks created by increased commercial lending and serve to protect the FSLIC.

Under the bill, savings and loan holding companies would be permitted to acquire up to five percent of the stock of non-affiliated savings and loans or savings and loan holding companies. Notwithstanding this limitation, securities subsidiaries of savings and loan holding companies would be allowed to underwrite and deal in these securities without regard to the five percent limitation. Under the Bank Holding Company Act, all shares of non-affiliated banks or bank holding companies must be included under the five percent limitation applicable to bank holding companies, regardless of where within the holding company such shares are technically held. We do not object to the securities subsidiary of savings and loan holding companies engaging in the activities proposed, but we believe such activities should be included under the five percent limit.

Holding Company Regulation

We support the bill's proposals to permit thrift holding companies to capitalize on some of the synergies available within the holding company framework and allow their subsidiaries to interact with each other under less onerous affiliation restrictions. For example, S. 2073 would replace the thrift industry's "conflict of interests" regulations with those applicable to banking institutions. In addition, mutual holding companies would be permitted to acquire stock FSLIC-insured institutions and to issue up to 49 percent of their common stock to the public. This authority will attract more capital into mutual holding companies and further foster their ability to convert to stock form.

We also favor allowing nondiversified savings and loan holding companies to incur debt in excess of 15 percent without prior approval. However, we would prefer raising the limit from 15 to 30 percent, rather than simply deleting the limit as proposed in the bill. Raising the limit would eliminate the prior approval requirement for a substantial number of debt transactions while at the same time ensuring the health of the thrift industry and the FSLIC.

Safety and Soundness Provisions

A few of the bill's safety and soundness provisions -- those affecting de novo institutions, net worth maintenance agreements, and management interlock exemptions -- may, in our judgment, serve not only to attract new capital, but also, unless amended, to increase the industry's risk of loss for the sake of short-term goals. As I have stated, both additional capital and the health of the thrift industry are of paramount importance, and any enhancement of the thrift charter must protect the industry, the FSLIC, and the taxpayer.

Under S. 2073, de novo institutions would be permitted to shed their special regulations after three years under certain conditions. Such a change appears reasonable on its face, but one result could be to permit de novo institutions to reduce their capital level below the six percent level. Current Bank Board procedures require de novo or newly insured institutions to maintain a seven percent capital level for one fiscal year and a six percent level thereafter. S. 2073 could allow such thrifts to adhere to those capital requirements below six

percent that currently pertain to other insured thrifts. Although competitive equity may argue for such a change, common sense surely does not. Treasury supports at least a six percent capital requirement, and last year's CEBA legislation strongly urged the Bank Board to move thrifts towards that goal. I see no reason why de novo institutions should be able to hold less capital in the interim, rather than lead the industry toward a healthier environment. Nevertheless, if any changes are to be made in this policy, they should be made by the Bank Board through the regulatory process.

The net worth maintenance provisions of S. 2073 would impose statutory requirements on the Bank Board to relieve, after three years, a savings and loan holding company which has acquired a thrift from its guarantee to maintain the net worth of the acquired institution. We believe that an acquiring institution should manage an acquired thrift so as to maintain capital at an appropriately high level. We also believe that there should be room for reasonable flexibility -- but the determination and scope of such flexibility should be made through the regulatory, rather than the legislative, process.

Treasury supports revising the restrictions of the Management Interlocks Act, but not as broadly as S. 2073. We would prefer that acquisitions made pursuant to the emergency acquisition provisions of the Garn-St Germain Act (but not any bank or thrift) be exempt, but only if the relevant federal regulator determines that no substantial conflict of interests or substantial lessening of competition would result. This would reduce S. 2073's burden on the federal regulators to review innumerable cases and preserve a concern for safety and soundness, while also attracting capital into the troubled sector of the thrift industry where it is most sorely needed.

Conclusion

In conclusion, I want to reiterate Treasury's support for thrift charter enhancement for a significant number of S. 2073's provisions, and for all of them if amended to reflect our concerns. Private solutions to the thrift industry's travails must be emphasized, especially when proposals for a taxpayer bailout are emanating from some quarters in the savings and loan industry.

That concludes my prepared remarks, Mr. Chairman. I thank the Committee again for the opportunity to testify on this subject, and I will be happy to answer any questions the members of the Committee might have.

APPENDIX

Treasury Position on S. 2073, the "Thrift Charter Enhancement Act of 1988"

Section 101 - Commercial Lending. Treasury supports increasing from 10 to 20 percent of assets the commercial lending authority of thrifts, but only if those thrifts which engage in commercial lending in excess of 10 percent of assets also hold capital reserves in an amount equal to those required to be held by commercial banks.

Section 102 - Investment in Service Corporations. Treasury supports expanded authority for thrifts to invest in service corporations, but prefers the approach taken in S. 2592, the 1986 Garn bill. S. 2592 provided for a more equitable distribution of such authority between the banking and thrift industries by permitting banks with $250 million or less in assets to invest to the same extent as thrifts in service corporations with the same powers as thrift service corporations, including real estate development and general insurance agency powers. This same service corporation investment authority would also have been extended to any bank holding company which acquired a troubled thrift. In addition, the 1986 Garn bill stipulated that thrifts not in compliance with their capital requirements at the time of enactment would have to phase in the expanded service corporation investment authority upon attaining the minimum capital level.

Section 103 - Small Business Investment Companies. Treasury supports modifying the limit on investments in small business investment companies from no more than one percent of assets to no more than either one percent of assets or five percent of capital, but only if such additional authority is limited to well-run, well-capitalized thrifts.

Section 104 - De Novo Institutions. Treasury opposes a legislative limit of three years on the requirements placed on de novo and other newly insured thrifts, particularly the six percent capital requirement. Treasury favors higher capital requirements overall for the sake of safety and soundness. In addition, any such changes (like the requirements themselves), should be addressed through the regulatory, rather than the legislative, process.

Section 201 - Definition of Affiliate. Treasury does not oppose permitting the service corporation subsidiaries of state-chartered multiple thrift holding companies to engage in state-authorized activities to the same extent as the service corporation subsidiaries of other state-chartered thrifts. The amendment would provide for competitive equality, given the likelihood that, without the amendment, a state-chartered institution which becomes part of a multiple thrift holding company may have to restrict substantially the activities of its service corporation subsidiaries.

Section 202 - Unitary Thrift Holding Company. Treasury supports allowing unitary thrift holding companies to own two healthy thrifts without additional restrictions if they have acquired at least one troubled thrift, but only if the second healthy thrift is acquired in conjunction with (or after) the acquisition of another troubled thrift. That is, any unitary thrift holding company that currently owns one healthy and one troubled thrift should not be permitted to purchase another healthy thrift, unless it also purchases another troubled thrift.

Section 203 - Affiliate Transactions. Treasury supports subjecting thrifts' affiliate transactions regarding the purchase, sale, or lease of property or assets and the contracting of management, advertising, or consulting services to the "arm's length" restrictions applicable to commerical banks. This would not only make bank and thrift regulation more uniform, but also serve to prohibit subsidiary thrifts from upstreaming funds under the guise of paying for services rendered. More in keeping with our general policy would be to apply Sections 23A and 23B of the Federal Reserve Act to all transactions between the holding company and the affiliate.

Section 204 - Activities of Thrift Holding Companies. Treasury supports permitting thrift holding companies to acquire directly up to five percent of the voting shares of a non-affiliated thrift or thrift holding company and allowing a securities firm subsidiary to underwrite and trade in such voting shares. However, Treasury opposes exempting the securities firm subsidiary's holdings of these voting shares from the five percent limit on safety and soundness grounds.

Section 205 - Interlocking Directorates. Treasury supports repealing the interlocking directorate provision of the National Housing Act. Director or officer interlocks of thrift holding companies are also governed by the Depository Institutions Management Interlocks Act, and the amendment would eliminate the unnecessary redundancy.

Section 206 - Amendment to the QTL Test. Treasury opposes increasing the amount of liquidity and loan origination investment which can count towards meeting the QTL test. The QTL test imposed by the Competitive Equality Banking Act (CEBA) intended to permit only those thrifts primarily engaged in housing finance to take advantage of expanded activities. Treasury holds that thrifts not primarily engaged in housing finance should become more, rather than less, like banks.

Section 207 - Cross Marketing. Treasury supports repealing the cross marketing restrictions on thrift holding companies that purchase failing thrifts.

Section 208 - Affiliate Investment. Treasury does not oppose permitting any thrift or other subsidiary of a thrift holding company which has acquired a troubled thrift to engage in those transactions permissible under Sections 23A and 23B of the Federal Reserve Act without regard to the activities of the affiliate. This will draw capital toward troubled thrifts.

Section 209 - Mutual Holding Companies. Treasury supports allowing mutual holding companies to acquire a stock thrift and empowering a mutual subsidiary to issue up to 49 percent of its stock to the public to increase the amount of capital available to mutual holding companies.

Section 210 - Debt Approval. Treasury opposes eliminating completely the current restriction on nondiversified thrift holding companies which prohibits them from incurring debt in excess of 15 percent of their consolidated net worth without advance approval from the FSLIC. However, Treasury supports increasing the limit to 30 percent, thereby effectively eliminating the prior approval requirement for a substantial number of debt transactions without increasing risk. On the other hand, eliminating the 15 percent debt limit with neither a phase-out nor a ceiling, and without limiting debt in excess of 15 percent to well-capitalized institutions, may increase the risk of loss to the FSLIC.

Section 211 - Net Worth Maintenance. Treasury does not oppose the concept of limiting to three years the perpetual guarantee by a thrift holding company to maintain at a certain level the net worth of newly acquired thrifts. However, we oppose making such changes through the legislative, rather than the regulatory, process.

Section 212 - Transactions With Affiliated Persons. Treasury supports replacing the FSLIC's "conflict of interest" regulations with those promulgated by the federal bank regulators to make more uniform the regulation of banks and thrifts.

Section 301 - Management Interlocks Act. Treasury opposes adding two new sections to the Depository Institutions Management Interlocks Act which would exempt companies which become holding companies upon acquiring thrifts pursuant to the emergency acquisition provisions of the Garn-St Germain Act and any bank or thrift whose interlock would not substantially lessen competition or lead to a substantial conflict of interest, as determined by the appropriate federal depository institution regulator. Treasury favors

expanding the interlock exemptions, but only to induce the acquisition of troubled thrifts. Accordingly, companies which acquire thrifts pursuant to the emergency acquisition provisions of the Garn-St Germain Act and thereby become holding companies should be exempted, but only if the appropriate federal depository institution regulator determines that the interlock would not substantially lessen competition or lead to a substantial conflict of interest.

The CHAIRMAN. Thank you very much, Mr. Sethness.
Chairman Wall.

STATEMENT OF M. DANNY WALL, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

Mr. WALL. Thank you.

Mr. Chairman, members of the Banking Committee: It's a pleasure to be here, albeit in response to a very recent invitation to do so.

Let me take a couple of minutes to talk about the Federal Home Loan Bank Board and the activities and status of the industry. I will do so briefly, because of course you have a hearing scheduled for about a month from now at which time you, as I understand it, intend to spend more time and greater detail on the condition of the industry.

STATUS OF THE THRIFT INDUSTRY

A couple of comments in terms of the status of the industry and as we have of late been referring to it, its bifurcated nature. Ninety percent of the industry is solvent. Ninety percent of the industry is doing very well. In 1987, this segment of the industry made $2.7 billion in net profit. Its capital to assets ratio is 5.71 percent, which is up one-quarter of 1 percent from the previous year.

The 10 percent of the industry that's insolvent continues to be a drag on the industry as a whole. Last year this segment lost $9.5 billion and its capital to assets position was a negative 15.75 percent. So that clearly we appreciate the importance of eliminating those problem institutions as we have been doing and as we are continuing and will continue to do.

In the 5 months following October of last year, which of course coincidentally was the month of the stock market crash, the average net new deposit growth in FSLIC insured institutions as a whole has been $4.5 billion, $4.5 per month of net new deposits. That's not, of course, interest and dividends accrued, but net new deposits.

In the 9 months prior to that, from January through September of last year, there was an average monthly outflow of $1.5 billion. So that the inflow over the last 5 months has now more than offset the outflow that was occurring in the period prior to the stock market crash and it occurred during a time when confidence in FSLIC insured depository institutions was perhaps in some minds at least, in question. It's clear that the consumer confidence in FSLIC insured institutions has returned.

As we indicated earlier in the week in another hearing here in this building, consumer confidence is evidenced by the fact that the depositors have come back to insured depository institutions of all types and have indeed left the stock market.

There are 3,200 FSLIC insured institutions in the thrift industry. They have within them $1.25 trillion in assets, and $900 billion in deposits, in over 100 million accounts. So that in terms of serving the American family, individuals, the elderly, the thrift industry and thrift institutions collectively clearly are doing so through those 100 million accounts.

FSLIC insured thrifts have within their portfolio 40 percent of all the mortgage debt that exists in the United States which totals $690 billion. The Federal Home Loan District Banks represent an important part of the strength of the industry in its structure. You should consider these institutions as the wholesaling sector of the industry. The 12 district banks hold $154 billion in assets and just under 9 percent in capital, which makes them perhaps the strongest capitalized financial institution in the country. By their asset size of $154 billion, they would rank as the second largest financial institution in the country.

Last year, those 12 district banks paid $1.32 billion in dividends, both in cash and in stock. So that as I said, they represent a source of significant strength within the industry, and are a reflection of the fact that a significant portion of the industry is profitable and utilizing their wholesale providers of liquidity and credit in a profitable way.

Let me shift then to the legislative package that is before you and make three general comments and then move on to a very brief review of the specific sections.

DEREGULATION

One of the things that many, many people have given focus to lately has been the subject of so-called deregulation. Whether they speak of it as deregulation in a generic sense, whether they speak of it as deregulation as per the Garn-St Germain legislation, or other references of deregulation, many of those commentators are in error when they talk about deregulation from a products and services standpoint as they make reference to Federal deregulation.

The deregulation that is the most significant part of the problem of the thrift industry is deregulation of longstanding authorities provided to state chartered institutions that offered opportunities for abuse after the implementation of the rate deregulation statute in 1980, and the results thereof as promulgated by the Depository Institutions Deregulation Committee. Without constraints on what could be paid for funds, powers available at the State level were able to be utilized by institutions whether it be in States like Texas or California where the legislation was changed by the state legislatures more recently, or in the States of Florida, Louisiana, or Utah, to attract deposits to fund high risk and poorly underwritten investment schemes. The list goes on and on, where State deregulation has occurred contributing in very large part to the problems of the FSLIC insured institutions.

Second, the matter of timing. Timing in a legislative sense, as I well know having sat on the other side of this table many times in this room—timing is everything, and with respect to this legislative package, we don't think that now is the time.

Third, many times statutory restrictions and/or authorities provide or remove from the regulatory agency—in this case, the Federal Home Loan Bank Board—the kind of flexibility that we ought to have to tailor regulations responsive to specific conditions in the industry. By putting into legislation either restrictions or permissive provisions will require this agency to take actions that we think ought not to be taken at the present time. I will subsequently refer to some of these provisions contained in the legislation as I move through the section references.

Let me quickly, trying to stay within your time frame, reference the various sections of this bill and give you quick comments as far as what we think is appropriate. I have just a limited amount of time to focus on each of these provisions.

One more comment perhaps before I move to that. I heard some of Senator Garn's comments as I was coming in. He stated that many of these issues have been discussed and in fact have been in legislation that has been introduced here in the Senate before, some of that legislation by Senator Garn, some of which I myself worked on. The provisions and the language in many of these sections are items that we're very familiar with even in a personal sense, but, recalling the matter of timing—now isn't the time.

Section 101, would expand the commercial lending authority from 10 to 20 percent. Of course, in most of these cases, we're talking about federally chartered institutions with very few exceptions, and this is clearly one of them. Most institutions are not now using the full amount of their 10 percent commercial lending authority and, indeed, the expansion of this authority would only affect a very limited number of institutions, if any. We are very concerned as to whether it's appropriate to make this kind of an expansion in commercial lending authority when the indications are that in certain states where there are presently no limits or where there are significantly greater limits, that problems have arisen.

We also, because of the way that the regulations have been interpreted by the Federal Home Loan Bank Board, consider junk bonds as commercial lending by the institutions. So that to increase this category by 10 percent would be, under the existing interpretations of regulation, to permit another 10 percent of junk bond investment. To the extent that you are concerned about that form of investment, it's something you need to give consideration to as you look at this particular provision.

On the other hand, it could cause there to be a reassessment or perhaps even new regulations vis-a-vis junk bond authority as it exists within the 10 percent commercial lending limit versus just including that available to an institution within the service corporation authority. Possibly the net effect of increased commercial lending authority would be a taking away of junk bond investment authority for the institutions. So even those who would advocate these changes ought to consider more seriously and more calmly the consequences of their proposal.

Section 102 would increase the service corporation authority from the 2 percent plus 1 percent to a 4 percent plus 1 percent with perhaps an additional 5 percent bonus if you deal with a troubled institution. We certainly would support the first part of that, proposal to increase the service corporation authority by 2 percent. On the second part, however, we're not so sure. Again, the issue of junk bond authority comes to mind because this is an area where junk bond investment authority exists.

Section 103 would increase the authority to invest in the small business investment corporations. We clearly would support that. I don't need to say any more.

Section 104 would limit to 3-years regulatory capital and net worth restrictions for de novo institutions. Here's one of those cases where to do this in statutory language would take away the

kind of regulatory authority that an agency such as ours may need in a particular situation or in a particular period of time where perhaps the application for de novo institutions might be absolutely exploding, as was the case just a few years ago in California where there were 200 pending applications for de novo institutions. If the agency would be restricted by these kinds of provisions by statute, we would not have the ability to act, we think, appropriately as the circumstances would require. On the other hand, we are indeed trying to be more sensitive to the problems and the challenges of de novo institutions. As an example, we have eliminated what previously had existed as a quarterly examination requirement, on the basis that it was absolutely unnecessary and in a sense overkill.

We are already making changes on the net worth maintenance front as well. In that regard we are moving from the so-called poison pill approach to prenuptial agreements. Rather than having an owner of an institution make total commitments of unlimited capital without any restrictions, we are moving to their providing this prenuptial agreement, where upon reaching a certain level of capital above zero, we have the ability to take the institution if the acquirer is not willing to provide more capital.

Section 201 would exempt multiple S&L holding company restrictions from service corporation activities with a state charter. We believe that the present statutory authority is authority that we need. To change it would be a disincentive to our efforts in directing people toward dealing with problem institutions.

Section 202 would expand the exemption from section 408(c) restriction if two S&L's are owned by the holding company if that holding company also purchases a troubled institution. There clearly are drafting problems with this. As we read this provision, it would have retroactive effect, so that if you have once, or ever, acquired a troubled institution, you could take advantage of this exception. There also is no proportionality in terms of a large institution could take a very small troubled institution and thereby gain this benefit.

Section 203 would increase the limits on the affiliated transactions to the greater of $100,000 or one-tenth of 1 percent of assets. It's currently the lesser. We think it would be acceptable, but we would prefer in both Sections 203 and 208, to see the applicability of Section 23(a) and Section 23(b) of the Bank Holding Company Act.

Section 204 would allow a savings and loan holding company to own 5 percent of the stock in an unaffiliated S&L. This provision would give the S&L holding companies parity with bank holding companies, something they don't currently have. On the other hand, because S&L holding companies may be in the securities business as explicitly provided for in CEBA and, as has always been statutorily permissible, we are concerned that if there is to be such a change, that you also take into account the market-making and underwriting activities that such a holding company might be involved in in the normal course of their business.

Let me perhaps interrupt there. I think we have touched on most of the important elements of the sections of the bill and I would be happy to respond to questions on any of the other specific ones.

The CHAIRMAN. Thank you, Chairman Wall.

For the record, by April 15th, the Committee invited the witnesses who are here to testify this morning. We orally invited the Bank Board to testify on this bill at that time. The staff of the Banking Committee was told on April 23rd that the Bank Board did not wish to testify. The staff learned only late last night that Mr. Wall would testify after all. So we are happy to have you here and any witness who can convert a poison pill into a prenuptial agreement is welcome. [Laughter.]

The CHAIRMAN. Of course, there are some people who think that a prenuptial agreement is usually a poison pill. [Laughter.]

Mr. Sethness, do you see anything wrong in allowing any commercial or industrial firm to own a bank or savings and loan?

BANKING AND COMMERCE

Mr. SETHNESS. With appropriate protections to avoid having the benefits of deposit insurance flow to the commercial institution, no, sir.

The CHAIRMAN. Is it not true that this bill would constitute a major step toward removing the barrier between banking and commerce, a step you otherwise favor?

Mr. SETHNESS. I am not sure that I would characterize it as a major move beyond the abilities that already exist in the unitary thrift holding company. It would enhance the opportunities.

The CHAIRMAN. Well, that's right. It would enhance the opportunities for virtually any institution to own a savings and loan, the first step toward merging——

Mr. SETHNESS. But it doesn't really expand what already exists, Senator, I don't believe. So we're quibbling over whether it's a major change or whether it is a slight enhancement to people being interested in doing it.

The CHAIRMAN. Let me approach this from a little different standpoint. The thrift industry problem has been with us for the whole of this decade. On several occasions during this period we have been told that giving the S&L industry additional powers would allow it to overcome its problems.

In 1980 in the Depository Institutions Deregulation and Monetary Control Act, and in 1982 in the Garn-St Germain Depository Institution Act, we responded to that assertion. We have thrifts expanded powers. These two acts achieved many worthy objectives, but they did not solve the thrift industry's problems.

Why should we believe that the thrift industry, which is a patient now sicker than ever, should respond to more of the same previously ineffective medicine?

Mr. SETHNESS. I don't believe that anybody is claiming that this is going to solve the thrift industry's problems. I think the assertion which I believe is that this would make it more attractive for somewhat more private capital to come into the industry to benefit the amount of money that otherwise either FSLIC or ultimately the taxpayer might have to put into it.

Why you should believe those assertions now—our comments on the specific proposals would limit the expansions of authorities to those situations where adequate capital was in place to support the enhanced activities. I believe, for my part, that a significant part of the problem with the activities that have been expanded in the past is that they have not necessarily been required to be support-

ed by adequate capital, and I think that one could also admit that there have been some failures in supervision which we believe have been significantly turned around since the previous actions.

The CHAIRMAN. Do you believe that the bill provides adequate safeguards against risk-taking by thrift institutions that have no real capital but that may still appear to be solvent under regulatory accounting principles, or even under generally accepted accounting principles?

Mr. SETHNESS. As my statement says, I don't believe that the bill, as drafted, adequately protects against that.

The CHAIRMAN. Chairman Wall, in his description of the thrifts' problem in today's Washington Post, Robert Samuelson writes: "This is a story of greed, stupidity, bungled regulation and in some cases criminality."

Why should Congress grant expanded powers to an industry in such sad shape?

Mr. WALL. I think in some sense, Senator, that's what I said when I made my introduction—that timing is everything and, in this case, we don't think it's the time.

The CHAIRMAN. In this case, you don't think it's the time?

Mr. WALL. That's right. And let me make again the distinction that I made at the outset, which is that many of the problems that have been identified have not involved federally chartered institutions. Unfortunately, too few of those who comment realize the distinction between a state charter and a federal charter, and that state charters in many states are very, very permissive and yet still insured by FSLIC versus federal charters which have restrictions. Some additional leeway and some additional competitive opportunities should be provided to federally chartered institutions in the future, but now is not the time because we can't make that distinction in the minds of many. People aren't willing to sit still and listen to the distinction between a federal charter and a State charter to understand. Maybe some States ought to be more restrictive than they've been, but on the other hand, in some situations the federal charter ought to be more permissive.

The CHAIRMAN. Specifically, what's the Bank Board doing to constrain greed and criminality in the industry?

Mr. WALL. The previous board I think in a very courageous move made the delegation of the responsibility of the examination and supervision functions to the 12 district banks. That was July 1, 1985. At that time, there were just over 1,000 professionals involved in the examination and supervisory functions.

Today there are over 2,000 involved in that process and they are better paid, so that we have better educated, better trained, better experienced and twice as many people doing what half as many were doing in 1985 with less education, less training, less experience, and there are fewer institutions than there were in 1985.

So that there are significantly better forces in the field as far as the federal examination and supervision function is concerned and I think that is a very appropriate move.

The CHAIRMAN. Senator Karnes.

Senator KARNES. Thank you, Mr. Chairman.

The first question to both panelists is about your feelings as to whether or not this piece of legislation would attract capital to the thrift industry—new capital.

POSSIBLE ATTRACTION OF NEW CAPITAL

Mr. SETHNESS. I believe that it would have the effect of attracting additional private capital.

Mr. WALL. I would agree that it has the prospect of aiding the attraction of new capital. We are already seeing new capital eagerly interested in coming into the business. This would give them perhaps more reason to be interested in doing so, especially at the margin.

Senator KARNES. Mr. Wall, you have been actively involved in seeking new capital to the industry and you've done very well. I compliment you for that.

In your discussions with some of these providers of new capital, new investors in the thrift industry, are there items mentioned that are included in this bill that would make it easier for you specifically to put some of the proposals and deals together, if you will, that you've been working on?

Mr. WALL. There are items mentioned, but in virtually every case—I'm quickly trying to go through in my mind those things that come up that are on this list—in virtually every case, under 408(m) of the CEBA legislation we have the authority to provide for waivers or forebearances to achieve the same end. So we are not prohibited from doing many of the things provided in your bill, with perhaps one or two exceptions. The lawyers will I'm sure find some reason why that's not a total answer, but for the most part we have the authority under the 408(m) waiver authority.

Senator KARNES. Of equal importance to attracting new capital is keeping the existing capital in the FSLIC and I guess in keeping the charters in the FSLIC. Is it your understanding, Chairman Wall, that the provisions of this bill would be well received by those various institutions that are now considering leaving the FSLIC and might this create an incentive for them to stay?

Mr. WALL. Well, in large part, the institutions that at least are talked about in the press as considering leaving are not talking to us. There are approximately 40 institutions that are grandfathered as a result of being in the pipeline at the time the CEBA legislation was finalized by Congress and signed by the President, and 13 of them are all that have seen fit to move.

We hear rumors and we read speculation by reporters and others that there is a large number of institutions that are preparing to do so. We have no indication of that. Much to the contrary, the institutions that are FSLIC insured are continuing to do what they think they should do in terms of managing and properly utilizing their capital and their stock responsibilities where they are stock institutions. On the other hand, we've had and continue to have interest in conversions from FDIC insured institutions to FSLIC insured status for a number of reasons. In some cases, charter changes, and in some cases, just a view that the FSLIC authorities and FSLIC insurance is more appropriate to their line of activity.

So while we see and read speculation that there are those who might merge as of August 10 when the moratorium is set to expire, we see no indication of that. And even those who could shift today are not doing so.

Senator KARNES. You mentioned the importance of timing. What would be in your mind the appropriate time for legislation of this nature to proceed?

Mr. WALL. I think at a calmer time in terms of the industry and in terms of the public attitude toward the industry. When perhaps the commentators and reporters who speak to and about the industry and yet are not completely familiar with the distinctions—as I said, the fact that a state charter is one thing and a federal charter is far more restrictive—when they understand these distinctions and that these kinds of proposals are very appropriate to the extent they provide for an expansion of what a federally chartered institution may do, the time will be right to discuss these proposals. You can't make these distinctions in people's minds right now, their eyes are not on that issue and we need to be dealing with the issue their eyes are on, which is resolving the problem institutions.

Let me also say in response to the other comment that you made about bringing in new capital, you've seen indications in the newspaper that new capital is coming into the thrift industry, but let me put it this way, Senator and all the members of the committee, you ain't seen nothing yet from the standpoint of those who want to come into the business and the amount of capital they want to bring with them.

Senator KARNES. Many of the provisions of this bill increase the powers of federally chartered savings associations. What percentage of the problems in the thrift industry are caused by federally chartered institutions as opposed to State institutions?

Mr. WALL. The preponderance of problems historically for FSLIC have been caused by the state-chartered institutions, but I'll have to give you a more specific statistic as a followup. I don't have a statistic as such.

Let me also make this additional caveat, and that is that through the course of deterioration of institutions, many are converted from state charter to federal charter even before there's a resolution. So that the final resolution may involve many federally chartered savings and loans, but in fact the problems occurred when it was still a state chartered institution at an earlier stage.

Senator KARNES. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Cranston.

Senator CRANSTON. First, I'd like to compliment Senator Karnes on this measure which I think is a very constructive effort to address the crisis in the savings and loan industry and the FSLIC. It doesn't purport to solve all the problems of the industry, but it does address one critical problem, and that's the continued erosion of the capital base of the industry.

And I would like to be a cosponsor of this measure and work with you on it.

I'd like to ask first, Mr. Wall, would you support the bill if a provision was added to prevent any thrift from taking advantage of the provisions in this bill if the thrift did not meet at least a 6 percent net worth standard or the highest net worth standard required by the Federal Home Loan Bank Board?

Mr. WALL. That's a pretty sweeping question, Senator, because there are some provisions here that we might find desirable to encourage an institution to take a troubled institution. In such cases

such an acquisition may in fact take the capital of the acquiring institution down below 6 percent or below a 4 percent level at a given time. Where it's to our advantage and to that institution's advantage to acquire the troubled institution, the imposition of such a requirement would be a disincentive. So I think your suggestion is too sweeping for me to respond.

Senator CRANSTON. If thrifts are required to meet higher capital standards to take advantage of the bill's provisions, would that requirement alone be enough to protect the safety and soundness of the thrifts? Could you provide in writing to the Committee a list of provisions that could be added to the bill to better protect the safety and soundness of thrift entities?

Mr. WALL. We'll certainly try to be as responsive as we can to those kinds of provisions.

Senator CRANSTON. I would appreciate that very much. We need your advice on that point.

I have a slightly longer statement I would like included in the record.

The CHAIRMAN. Without objection, so ordered.

[Committee insert of Senator Cranston's opening statement.]

THE COMPLETE PREPARED STATEMENT OF SENATOR CRANSTON

Senator CRANSTON. Mr. Chairman, I appreciate your holding hearings at this time on Senator Karnes' bill, S. 2073, the "Thrift Charter Enhancement Act of 1988".

This bill addresses a serious subject—the crisis facing the savings and loan industry and the Federal Savings and Loan Insurance Corporation. It does not purport to solve all of the problems of the industry, but it does address one critical problem—and that is the continuing erosion of the capital base of the industry.

It appears from the figures that I have seen that the segment of the industry that is losing money is doing so faster than the profitable segment is making money.

The bill's purpose is to attempt to stem this outflow by attracting new capital to the industry. This would be done by making the S&L charter more attractive to outside companies. The bill also has provisions to encourage healthy institutions to acquire failing ones.

S. 2073 is particularly welcome because it does not propose the use of Federal funds to accomplish its goals. It would accomplish them by amending the Savings and Loan Holding Company Act to remove what are believed to be obsolete provisions that are disincentives for potential buyers of S&L's. It would also expand somewhat the powers of federally chartered S&L's and make some changes in legislation relating to officer and director interlocks between dispository institutions and their holding companies. Also, there is an increase in service corporations investment authority from 3 to 5 percent.

While I do not agree with every provision in this bill, I believe we should begin to focus attention on keeping the healthy part of the savings and loan business up and going while we are trying to solve the problems of those thrifts that are in a crisis. The Savings and Loan Holding Company Act has been on the books for 20 years and the Interlocks Act for 10 years, and a review of this legislation

in light of today's problems may yield some valuable suggestions for change.

Infusion of capital into this industry is certainly a laudable goal. Whether this bill goes too far—or not far enough—remains to be seen. I am cosponsoring this bill today because I believe incentives for increased capital is greatly needed in this industry.

I look forward to studying the statements of the witnesses who are appearing here today in greater detail and to hearing testimony.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bond.

Senator BOND. Thank you very much, Mr. Chairman.

I apologize. I was involved in an Agriculture Committee hearing on the stock market crash of October 19 and I wanted to see if they were telling us the same things over there that they were over here and I apologize for having missed out on some of Mr. Wall's testimony.

But I gather you don't feel that this is the year to have any additional thrift legislation. Is that correct?

Mr. WALL. That's right, Senator. We think that the timing is such that we ought to be given time to utilize the resources that this Congress gave us last year in the recapitalization authority that we received, particularly as we procede with those kinds of case resolutions and negotiations, some of which you're reading about—more of them, fortunately, you're not reading about. We need time and we need patience to put to work at least a significant portion of those resources and demonstrate the extent to which those resources are sufficient to deal with the problem.

Senator BOND. Well, I certainly commend you for being willing to take on your position in a difficult time. I think I raised some warning flags and asked you at your confirmation hearing if you really wanted the job, and I know you're doing a good job in a difficult time, but I'm being asked by constituents who are knowledgeable about this area, who say that obviously you didn't do enough in the FSLIC recapitalization. What is the next step? What are you going to do after that?

These are people who are familiar with the industry, several of them who actually work in it, who are convinced that we're far short. What do you see as the longer-term solution? Or can I tell them that you can handle it with the recapitalization authority you have?

LONG-TERM SOLUTION

Mr. WALL. The Congress in 1986 was given a plan that called for a $15 billion borrowing authority for FSLIC that would have been leveraged into $25 or $25 plus billion over time and that was "the solution." By the end of that session of Congress it was not possible to come to a resolution on one common package between the two bodies, so the legislation carried over to 1987.

In 1987, the discussion and the debate began on the question of $15 billion in borrowing authority or $5 billion in borrowing authority. The question, as I read it, was "the solution or taking a piece of the solution." The ultimate decision by Congress was to go

with a piece of the solution, approximately $11 billion—$10.825 billion. The Congress and the next President will be able to assess how far we will have been able to work through the problem with those resources. That's what we're doing and that's the point that I made in terms of we—everyone—needs to recognize that the Congress has put up the authority for the industry to recapitalize itself. Some in the industry don't want to have to do that. They don't want us to use all of the resources that have been provided for within our authority, but Congress instructed that we should progress and gain experience toward resolving the problem so that the next Congress and the next President can assess the situation. And I think that's what we ought to do.

Senator BOND. In addition to that, the option that is set forth in Senator Karnes' measure, which I cosponsor, seems to me to be an additional helpful tool. Are there other things that you could recommend or that you would consider for the future?

Mr. WALL. Well, Senator, I certainly understand the problems of schedule. As I indicated before you came in, many of the authorities provided in this legislation we already possess, because of the authority in the CEBA legislation, to give waivers, and grant exceptions for to those who will take troubled institutions. In some of the cases, the authority and the provisions of this proposed legislation would give that authority to everybody, whether you took a troubled institution or not. Some of the provisions are tied to having dealt with a troubled institution. In these cases, we are concerned there is no restriction as to what the size of the troubled institution might be vis-a-vis the size of the entity that would get the benefits for having dealt with the problem institution.

So we agree with the thrust many of the provisions in this legislation and we're utilizing those authorities already through the specific legislation that you gave us last year.

Senator BOND. Thank you.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Mr. Chairman, some of the questions that I'm going to be asking relate to this bill as well as anticipation of hearings that we're going to be having in May on a broader look at the state of the thrift industry.

Mr. Wall, you commented about the fact that many States have liberalized the charters available to their institutions and that this had created some additional concerns within the Board as to the differences between a Federal charter and a State charter and what they would allow.

It seems to me that we have merged here two different questions. One is what I would call the regulatory question, including the chartering question. The second is the insurance question.

Focusing on the insurance question, what would be your feeling about a reexamination of the principle that any institution which has a State charter which meets State standards is automatically eligible for full Federal insurance coverage, or a second alternative that if eligible that there should be a variation of premium required to participate based on the assessment of the risks which that particular charter brought to the insurance fund?

Mr. WALL. Senator, one of your colleagues, Senator Sanford, asked me the same question at my confirmation hearing in June of

last year and my response then was, as it is again, that it's a very profound question.

Senator GRAHAM. Creativity is described as the art of disguising your source of your creation. [Laughter.]

Mr. WALL. I didn't mean it in that sense. I really mean that it's a very profound question for everyone to be considering, we as well. I come from a philosophical and political background that says States rights and I tend to err on the side of States rights. This is an issue and an area, be it FSLIC, be it FDIC, or be it the Credit Union Share Insurance Fund, where the Congress it seems to me has got to look at the question.

Clearly, all three of those deposit insurance entities have been or are under a state of difficulty and the Congress needs to look at the extent to which the State chartered aspects have contributed to that.

Now maybe the analysis will demonstrate that it wasn't the charter authority, but it was that there weren't enough examiners, both at the Federal level and at the State level. And if that's the case, then we will find that out. But it is clearly a question that needs to be asked and needs to be pursued.

Senator GRAHAM. Well, it will be asked when we're back together again next month and I would be interested if in the interim you could have developed some recommendations on behalf of the Board as to how you think Congress should deal with that question of the insurance function as distinct from the regulatory chartering function.

I regret, Mr. Chairman, that I'm going to have to leave, so I'm somewhat anticipating a statement that's going to be made in the prepared text by Mr. Theo Pitt, chairman of the U.S. League of Savings Institutions. He states on page 6:

> We would favor, however, language clarifying the ability of the Bank Board to use its extraordinary acquisition preemptive power to override the cross-marketing restrictions in supervisory cases.

This issue came up in a specific case in which the Board granted authority to an Iowa insurance company to acquire a Florida thrift and then granted to that acquired thrift the cross-marketing authority to sell insurance in spite of State law prohibition against such sale of insurance.

During a colloquy on March 29 consideration of the recent Proxmire bill, Chairman Proxmire stated that under emergency situations "unlike" institutions could acquire thrifts and override State law as necessary to permit the acquisition. Congress' intent was to permit this kind of acquisition without jeopardizing the acquiring institution's right to continue in its primary business in the face of any State restrictions on the activities of the acquired thrift.

Later, Senator Proxmire went on to state, "I do not believe Congress intended to permit the Federal Home Loan Bank Board to waive any State prohibition upon the activities of the acquired thrift institution." I think I could summarize the chairman's statement as distinguishing congressional intent as to the acquiring institution and the acquired institution in terms of congressional intent.

With that as a long premise, what was the basis upon which the Home Loan Bank Board allowed the acquired institution to engage in insurance activities which were otherwise prohibited by State law?

Mr. WALL. Senator, I'll have to give you in a followup the full legal analysis. I'm not a lawyer and as I've often said, thankful of it, and in this case more so.

Let me add one particular element if I might to the description you made of the particular case and that is that four institutions were involved. The Statesmen Group, which is a holding company that has several insurance subsidiaries and a securities subsidiary, now has an S&L subsidiary made up of what previously were four S&L's—three in Iowa and one in Florida. It is and was the Board's view that we had the authority to provide for that waiver under the law and we will provide you with the legal analysis that our staff had made of that.

Senator GRAHAM. Do you believe, as Mr. Pitt apparently believes, that that area of the Board's authority requires clarification?

Mr. WALL. I'll put it this way. If someone finds to the contrary of what we found, then we think it needs clarification. If we're successful, we don't think it needs clarification. We think we need the authority, in a word. I don't mean to be cute. We think we need that kind of authority. It's helpful. I realize it gives States difficulty and we talked about it earlier. There's a Federal responsibility here in insurance. There's a Federal responsibility in regulation. We believe the Congress intended that we have the authority and indeed the responsibility to maximize the resources that we have at FSLIC. This acquisition was one context in which we could maximize those reasources, by getting a significant body of new capital—human and financial—into the thrift industry in the form of the Statesman Group taking what previously were four troubled institutions.

Senator GRAHAM. When we meet again in May, we will pursue this question further.

The CHAIRMAN. Gentlemen, we have four other distinguished experts who will appear after you experts, but as a parting arrow, let me just ask one question of Chairman Wall.

A story in the April 25 Thrift News indicated the Bank Board is considering liquidating Freddie Mac. What can you tell us about those plans?

LIQUIDATION OF FREDDIE MAC

Mr. WALL. Well, I can tell you that it's just pure hogwash. I don't know where people come up with those kinds of ideas. There are clearly people who sit around and don't have anything more important to do than think about how can we get somebody's attention, whether it be a leak or whether it be a reporter. There is nothing to that story. There never has been. I wouldn't expect that there would be anything to such a story but it's raised an unfortunate situation because it is causing people in the marketplace who have an interest in Freddie Mac, whether they be the owners through the stock that is held by the institutions in the thrift industry or

whether they be those who buy or invest in the products of Freddie Mac. It's a most unfortunate piece of speculation and that's all it is.

The CHAIRMAN. You certainly come right to the point. That's one of the reasons why we admire and respect you and why you're such a good witness. Thank you very much.

Our panel consists of Mr. Theo Pitt, chairman of the U.S. League of Savings Institutions; Mr. Charles John Koch, first vice chairman of the National Council of Savings Institutions; Mr. William Cooper, director of the Association of Thrift Holding Companies; and Mr. J.R. Nunn, president of the Independent Bankers Association of America.

Mr. Pitt, go right ahead, sir. As I indicated to the other panel, you have 10 minutes and anything you can't say in that time will be printed in full in the record.

STATEMENT OF THEO H. PITT, JR., CHAIRMAN, U.S. LEAGUE OF SAVINGS INSTITUTIONS

Mr. PITT. Thank you very much, Mr. Chairman.

I am Theo Pitt. I am chairman and president of the Pioneer Savings Bank in Rocky Mount, NC and I appreciate the opportunity to appear today on behalf of the U.S. League of Savings Institutions.

First of all, I want to commend Senator Karnes for focusing the attention of this committee today on the various aspects of laws that govern federally chartered thrifts and savings and loan holding companies and the management interlock questions.

We agree that it is important to enhance the thrift charter and we commend Chairman Wall for the statements he's made to that effect.

We believe it's important both for the sake of our ability to serve the communities that we have served over these many years and also for the sake of restoring the thrift industry and the health of the FSLIC.

I'd like to highlight several points that are in my prepared testimony.

COMMERCIAL LENDING AUTHORITY

The U.S. League is not officially requesting at this time an increase in the commercial lending authority for federals as is provided in the first section of S. 2073. In my view, the provision has some considerable merit for some institutions that operate in particular markets and circumstances where prudent commercial lending opportunities do exist.

One reason the Federal associations have not more fully utilized the commercial lending authority that was provided in Garn-St Germain may be explained by the lack of corresponding full demand account services. It seems incredible to us that after 8 years following deposit deregulation that demand deposit service for businesses is virtually a monopoly still of the commercial banking industry. Likewise, businesses large and small are denied explicit interest return on their checking accounts.

If enhancing the thrift charter is an objective of this committee and the Congress, it might be well to start with removal of the re-

strictions on demand deposits at federally chartered thrifts and the payment of interest thereon.

Our League strongly supports the increase in the service corporation investment for federals from 3 to 5 percent with the top one percentage devoted to community development purposes.

The proposal to reward federals that acquire supervisory cases with additional investment authority could provide an important incentive we believe to assist the FSLIC with its case load.

As a general rule, we do not recommend statutory amendments to dictate a supervisory policy such as the differing treatment of de novo institutions as addressed in section 104. We recognize, however, the desire of the newly chartered institutions to gradually move into and be comparable in status with the other institutions and would suggest that this committee—perhaps in the report language—encourage the new Federal Home Loan Bank Board to review as soon as possible the various exceptional supervisory rules imposed on de novo institutions by the last Federal Home Loan Bank Administration.

Now I would like to turn to the changes recommended by S. 2073 for the Savings and Loan Holding Company Act. We at the U.S. League support the section which permits an S&L holding company to invest up to 5 percent of the voting stock of an unrelated FSLIC-insured institution or its holding company. This could broaden the market generally for savings institutions stocks and assist in efforts to improve the recapitalization effort.

We would also support the section which amends the mutual holding company authority adopted last year: First, empowering these new companies to acquire a stock as well as another mutual institution and, second, permitting issuance of common stock in a limited and a controlled manner.

The qualified thrift lender subject has a long history with this committee, culminating in the basic 60-percent standard which was adopted in CEBA last year after much discussion. S. 2073 would make several revisions. We can't support them all at this time because we believe it's too soon after enactment to make those changes.

One change we would encourage at the earliest opportunity is to remove the 10 percent limitation on liquid assets which may be counted toward the basic thrift lender standard. We believe that limitation is counterproductive, particularly during these times when depositories should be encouraged to have as much liquidity as possible to meet withdrawal pressures.

We also recognize that at the appropriate time some needed additional flexibility may be attained by broadening the categories included in the "housing-related" definition. Specifically, institutions should receive full credit for the mortgage loans that are originated and then are sold in the secondary market. We do not, however, support the reduction of the 60-percent figure at this time.

As you stated earlier, we believe that we're still focused on our mission, Mr. Chairman, and we believe that we have not abandoned as a general rule our basic commitment as the Nation's primary housing lender.

Similar to my advice a moment ago on another section aimed at the Federal Home Loan Bank's supervisory practices, we would

suggest that the new administration at the Bank Board review the practices regarding net worth maintenance agreements consistent with its desire to enhance the thrift charter. That would be preferable in our view to the statutory time limit which is dictated in section 211.

Finally, the League supports both the amendments listed in the third title of Senator Karnes' bill and the changes in the Depository Institutions Management Interlock Act, which was made by this committee and the Senate recently in the Proxmire bill. These changes we believe will assist savings institutions in retaining experienced directors.

Improving the thrift charter and the savings and loan holding company framework we believe are worthwhile goals. Again, we appreciate this opportunity to review these provisions of the Thrift Charter Enhancement Act. Thank you, Mr. Chairman.

[The complete prepared statement of Mr. Pitt follows:]

STATEMENT OF THEO H. PITT, JR.
On S.2073, the Thrift Charter Enhancement Act
Before the Senate Banking, Housing & Urban Affairs Committee
April 27, 1988

Mr. Chairman:

My name is Theo H. Pitt, Jr. I am President of the Pioneer Savings Bank of Rocky Mount, North Carolina and appear today as Chairman of the U.S. League of Savings Institutions.

The League and its 3,200 savings institution members appreciate this opportunity to testify on S.2073, the Thrift Charter Enhancement Act. We commend Senator Karnes for his initiative in focusing the attention of this Committee on various aspects of the laws governing federally-chartered savings institutions, savings and loan holding companies and depository institution management interlocks.

At the outset, let me say that the U.S. League agrees that it is important to preserve and enhance the opportunities of the thrift charter -- both for the sake of our ability to serve our communities and for the sake of the government agency which insures our deposits. This distinguished panel is familiar with the difficult challenges which today confront the Federal Home Loan Bank Board and the FSLIC fund it administers. We need to attract new capital to our institutions consistent with our specialized housing finance and community service roles.

When our organization held its annual Legislative Conference recently we had an opportunity to examine section by section the provisions of S.2073. Understandably, in constructing a bill to create new opportunities or address various statutory obstacles to operations, some provisions are more significant and deserving of more immediate attention than others. In a few cases we recommend against statutory change at this time.

I would now like to address the sections in S.2073, as introduced:

Title I- Amendments Affecting Federally-Chartered Associations

Sec.101. The U.S. League takes no position on enlarging from 10% to 20% of assets the investment "basket" for secured or unsecured loans for commercial, corporate, business or agricultural purposes. In the aggregate nationwide, commercial lending by our federally-chartered associations constitutes only a fraction more than 1% of assets today -- even though federals have possessed this broadened power since enactment of the Garn-St Germain law in 1982. Thus, very few institutions are likely to be bumping against the existing limit. However, in particular circumstances and markets, some federals may see prudent commercial lending opportunities and the suggested change of this section would be helpful.

One reason that federal associations may not have explored business and commercial lending to a greater extent may be explained by a continuing inequity on the deposit side of our business. Federally-chartered institutions may not offer demand deposit services -- ordinary checking accounts -- to business customers unless they have an established loan relationship. (Furthermore, federals do not possess demand deposit authority to serve individuals.) Without full service checking account authority, compensating balance flexibility, and similar marketing tools, it is difficult to penetrate the commercial lending market to even a modest extent.

It seems incredible that eight years after the heralded "deregulation" of deposits, demand deposit service to the business customer remains a virtually exclusive preserve of commercial banking institutions. There simply is no rational basis for preserving this de facto monopoly in the modern financial services marketplace.

Beyond the lack of full checking account authority, there is the longstanding ban on paying interest on demand accounts which applies to all depositories. For the individual, this is no longer a barrier to earning interest on household bill-paying accounts with the functionally equivalent, but legally distinct, NOW account available. However, businesses large and small are denied explicit interest on their account balances. The U.S. League has long advocated an end to this last vestige of protectionism -- which is a total anachronism in a financial world characterized by deregulation of every other category of depositor service.

If enhancing the thrift charter is an objective of this distinguished Committee in the remainder of this 100th Congress, it might be well to start with removal of the restrictions on demand deposits for federally-chartered thrifts and payment of interest thereon.

Sec.102. The U.S. League strongly supports an increase in the service corporation investment percentage for federals from 3% to 5%, with that in excess of 4% dedicated to community development purposes.

Service corporations are important profit centers for our business. They played a particularly valuable role during the thrift crisis of 1981-82, sustaining institutions caught in an negative interest-rate-spread vise. Most State-chartered savings institutions have greater service corporation authority, in activity as well as amount, than those with federal charters, creating competitive disadvantages. (The U.S. League acknowledges that some State-provided service corporation authorities are overly broad, though such FSLIC rules as those governing deposit growth and direct investment have largely contained the excesses.)

The language in S.2073 also recommends retention of the "top" percentage for community development purposes, as appears in the language of the present Section 5(c) of the Home Owners' Loan Act. This concept dovetails nicely with testimony received recently by your Housing & Urban Affairs Subcommittee on the Report of the National Housing Task Force. Jointly-owned service corporations funded by thrift institutions have been involved for many years in redevelopment efforts and multi-family housing for lower-income families. Similarly service corporation investment authority might be adapted to the "benevolent lending" and other concepts discussed in that report.

In addition, this section also provides an additional 5% investment authority for federals that have acquired or are acquiring -- or federals part of a holding company which has acquired -- a troubled institution. In some situations, this could provide a powerful incentive to strong, well-capitalized institutions and thrift holding companies to assist the FSLIC with its caseload and reduce the overall exposure of the deposit insurance fund.

We are aware, of course, that various real estate interests have objected in the past to any expansion of service corporation investment activity. The U.S. League believes such objections to be ill-founded and short-sighted. For example, service corporations typically engage in real estate development jointly with builder/developers as partners. This not only lends the stability of the financial institution management to the historically cyclical building process but creates opportunities where none might otherwise exist. Real estate brokers, of course, benefit as well when the project is ready for sale to the homebuying public.

Our industry strongly protests any statutory efforts which may still be forthcoming in this 100th Congress to hamstring service corporation investment and disrupt ongoing real estate activities at thrift institutions and their service corporations. A far better approach would be to expand, as Senator Karnes' bill suggests, permissible service corporation investment authority for federally-chartered savings associations.

Sec.103. Though the U.S. League is not aware of widespread interest in permitting a 1%-of-assets investment in Small Business Investment Companies, it has no objection to such a statutory change.

Sec.104. We must reluctantly refrain from endorsing the statutory declaration that, after three years, a de novo institution shall not be subject to regulatory requirements and restrictions distinct from those which apply to FSLIC-insured institutions generally. While the U.S. League has objected vigorously on a number of occasions to aspects of the Bank Board's differential treatment of newly chartered organizations, we nevertheless do not believe a statutory curtailment of the agency's authority in this area is merited.

In our opinion, the Bank Board as regulator is entitled to broad discretion in setting the standards it will apply as deposit insurer to new, as well as existing, institutions. To the extent de novo institutions are disadvantaged by the FSLIC's current rules following three years of successful compliance, we believe the ultimate best interests of all concerned will be served by preserving a regime under which recourse is sought through regulatory rather than statutory adjustment. In particular, we do not think it would be wise for Congress to relieve de novos of their strict capital requirements and to permit them to participate in the phaseup to the 6 percent level recently established for institutions generally; ambitious exercises in growth permitted by generous leveraging limits have cost FSLIC and the industry a great deal. Recourse should first be to the agency rather than through a broad statutory change.

Title II- Amendments Affecting Regulation of S&L Holding Cos.

Sec.201. The U.S. League has no objection to this change which would clarify that a State-chartered institution in a multiple holding company may engage in service corporation activities as permitted by State law notwithstanding the activities' restrictions enumerated for multiple holding companies. The statutory clarification would put service corporations of State-chartered thrifts in unitary and multiple S&L holding companies on an equal footing. If the Congress proceeds with this provision, we have an additional suggestion that the language be altered to permit a grandfathered "leeway investment" subsidiary of an institution which has converted to federal charter to qualify.

Sec. 202. Last year's Competitive Equality Banking Act contains an amendment which allows a unitary S&L holding company acquiring a troubled thrift to avoid the activities' restrictions which would otherwise apply to a company owning two or more institutions. This provision expands the concept further by permitting a holding company owning two or more healthy thrifts to enjoy the activities and affiliation flexibility of a unitary so long as one failing thrift has been acquired. The U.S. League takes no position on this provision.

Sec. 203. This section would liberalize the threshold in the S&L holding company law which limits to $100,000 the purchase, sale or lease of property or assets by insured institutions with their holding company affiliated companies. The dollar standard would become "the greater of" $100,000 or 0.1% of the insured institution's assets. As under existing law, such transactions could only occur with prior FSLIC approval. We are not aware of any widespread displeasure with the present law and take no position on this recommended statutory change.

Sec. 204. The U.S. League supports this change which would permit an S&L holding company to acquire up to 5% of the voting stock of an unrelated FSLIC-insured institution or its holding company. This is comparable to the "stakeout" authority already possessed by bank holding companies, which may acquire up to 5% of the voting shares of any bank. This provision could broaden the market for savings institution stocks and assist in the efforts to improve industry capitalization.

The provision also clarifies that an S&L holding company affiliate which is an investment banking firm or broker-dealer is not affected by the 5% limitation when conducting securities transactions involving S&L stocks in the normal course of its business.

Sec.205. The U.S. League has no objection to this section which repeals a provision of the S&L holding company law requiring FSLIC approval for a director/officer/controlling shareholder interlock with the board of an unaffiliated institution or holding company; the language largely duplicates protections appearing in the 1978 Depository Institutions Management Interlocks Act.

Sec.206. Our organization cannot support the alterations to the Qualified Thrift Lender test as set forth in the Thrift Charter Enhancement Act.

We do applaud one element of this section's revision of the QTL test: the ability to count all liquid assets toward the basic 60% real estate investment standard. The level of liquid assets varies frequently as lending opportunities develop, institutions stockpile liquidity to meet possible withdrawal pressures, and for other reasons. Maintenance of adequate liquidity is one of the fundamentals of a depository institution. Therefore, we would recommend that the Congress remove the 10%-of-tangible-assets limitation on liquidity items which may count toward the basic 60% level and permit all liquid assets (as defined by Section 5A of the FHLBank Act) to qualify.

Beyond that correction, we are content to wait and see how the language adopted just last fall in the Competitive Equality Banking Act works in practice.

Sec.207. Similarly, we see no need to revisit the language imposed in CEBA which limits the cross marketing of products and services in a diversified savings and loan holding company to those permitted bank holding companies and those offered as of March 5, 1987. While restrictions on "tandem operations" can go overboard and needlessly interfere with marketing practices among affiliates within holding company families, thus denying the public the ready availability of services, we

can contemplate situations where financial services in a diversified setting can so dominate the marketplace as to significantly reduce competition. Given the breadth of existing bank holding company activities, as well as those grandfathered and others which might be approved in the future, there is no need at this early date to repeal the cross marketing language adopted in Sec. 104 of CEBA.

We would favor, however, language clarifying the ability of the Bank Board to use its extraordinary acquisition preemptive power to override the cross-marketing restrictions in supervisory cases.

Sec.208. As an incentive for the acquisition of failing thrifts by S&L holding companies, this section of S.2073 permits their insured institutions to follow the restricted, but not prohibited, sanctions of Sections 23A and 23B of the Federal Reserve Act whether or not all of the business activities of the affiliates within the holding company family are permitted by Section 4(c) of the Bank Holding Company Act. The U.S. League has no objection.

Sec. 209. Our organization supports this provision amending the "mutual thrift holding company" authorization from CEBA in two ways. First, the provision empowers these new companies to acquire a stock, as well as a mutual, FSLIC-insured institution. This will simplify existing merger and acquisition mechanisms and enhance the value of the new holding company form designed to preserve the mutual form of depository ownership while availing management of expansion opportunities. Second, the language of this section permits a mutual institution subsidiary of a mutual thrift holding company to issue (to persons other than the parent holding company) common stock not to exceed 49% of issued and outstanding stock of the institution. This change could provide limited and controlled capitalization opportunities for this newly-authorized corporate form.

Sec.210. The U.S. League strongly supports this provision, which is a long-overdue improvement to the S&L Holding Company Act. That law requires non-diversified holding companies to receive prior approval from the FSLIC when they wish to float debt obligations in excess of 15% of consolidated net worth. Delays in the applications and clearance process have in the past frustrated management efforts to raise funds at desirable rates and terms, particularly in rapidly changing markets.

Secs. 211 & 212. As indicated with Sec. 104 earlier, we are reluctant to encourage statutory override of FHLBB rules and procedures. That is the case with Sec.211, which puts a time limit on net worth maintenance agreements, and Sec. 212, which dictates uniformity with the "conflicts of interest" rules used by the other federal banking agencies. The U.S. League cannot support these two sections.

Title III - Amendments to the Management Interlocks Act

Sec. 301. The Depository Institution Management Interlocks Act prohibits interlocking management officials among depository institutions and depository holding companies. S. 2073 would add two new exceptions to the Act. First, a company that became a depository holding company by acquiring a failing insured institution pursuant to the emergency assistance provisions of Section 408(m) of the National Housing Act would be exempt from the ban on interlocking management officials. Second, Federal banking and thrift regulators would be authorized to make an exception to the prohibition of the Interlocks Act upon a finding that a particular interlock would not result in a substantial lessening of competition or substantial conflicts of interest.

We support these amendments which will facilitate the acquisition of failing savings institutions and encourage the infusion of new capital into the thrift industry.

In addition, the U.S. League would like to commend this Committee for the three amendments to the Interlocks Act that were included in S. 1886, the Proxmire Financial Modernization Act of 1988. S. 1886 makes it easier for two institutions to be "affiliated" and therefore exempt from the Act by reducing the threshold level of common ownership from 50 to 25 percent. In addition, S. 1886 excludes advisory or honorary directors of institutions with total assets of less than $100 million from the prohibitions of the Interlocks Act. The Interlocks Act currently grandfathers management interlocks that either existed at the time the Act was enacted or were created when a company became a diversified savings and loan holding company. This grandfathering is scheduled to expire on November 10, 1988. S. 1886 extends this grandfathering for five years to November 10, 1993.

At a time when management is crucial to the thrift industry, we feel that the amendments proposed by S. 2073 and those incorporated in S. 1886 as passed by the Senate will assist savings institutions in maintaining experienced directors and other knowledgeable officials.

* * * * * *

This concludes my review of the various provisions of the Thrift Charter Enhancement Act. Improving the federal thrift charter and the savings and loan holding company framework are worthwhile goals. Now that twenty years have passed since its adoption, it is particularly important to reexamine the provisions of the Savings & Loan Holding Company Act. Indeed, your Committee and the Congress, working with the industry and the FHLBB, may wish at some point in the near future to undertake a fundamental streamlining of that law in light of changes in the financial services marketplace.

I have appreciated this opportunity to present the views of the U.S. League and look forward to your questions.

The CHAIRMAN. Thank you very much, Mr. Pitt.

Mr. Nunn, go right ahead, sir. Are you any relation to Sam Nunn?

Mr. NUNN. I'm sorry I can't claim any relation to him. He may be a little too smart for our side of the family.

The CHAIRMAN. Well, it looks like intelligence runs with the Nunn name. Go right ahead.

Mr. NUNN. When I get through you might not think that. [Laughter.]

STATEMENT OF J.R. NUNN, PRESIDENT, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. NUNN. Mr. Chairman and members of the committee, my name is J.R. Nunn. I'm president of the Independent Bankers Association of America and president of the Citizens Bank of Tucumcari, New Mexico. The IBAA is the only national trade association that exclusively represents the interests of independent community banking. Mr. Chairman, this may be our last opportunity for us to testify in front of one of your committees. We would all like to say that we appreciate the efforts you've put forth in behalf of community banking all these years. I would like to thank Senator Karnes for all of his efforts in behalf of community banks in helping to sponsor—and he was a key player in the Senate Agriculture Committee—for the secondary market for farm loans. Thank you, Senator.

I appreciate the opportunity to present our concerns about this bill. We commend Senator Karnes for seeking ways to recapitalize the thrift industry, but we strongly oppose several parts of his bill.

OPPOSITION TO SECTIONS OF BILL

The Karnes bill proposes two basic solutions to the current thrift crisis. First, it would further expand thrift commercial lending authority. Our Association opposed this idea in 1981 and we continue to oppose it today. Second, the bill would attempt to attract more private capital by making it easier for commercial firms to own thrifts. Such a change would aggravate the nonthrift thrift loophole and further breach the separation of banking and commerce.

Just last year, through your leadership, Mr. Chairman, Congress reaffirmed its support for separation of banking and commerce by closing the nonbank bank loophole in CEBA. As you know, former Fed Chairman Paul Volcker strongly argued that it was also essential to close the nonthrift thrift loophole because this undermines the separation of banking and commerce.

In CEBA, Congress attempted to draw a line between those thrifts which have a substantial commitment to home lending and those which do not. The QTL and cross-marketing restrictions were two lines Congress drew. Under the QTL test, the thrift subsidiary of a holding company must devote at least 60 percent of its assets to housing and related activities. If it meets the 60 percent test, the parent holding company can engage in almost any nonbanking activity.

Also, CEBA prohibits a diversified thrift holding company from using its thrift to cross-market products or services that are not

available to a bank holding company. These restrictions are similar to those imposed by grandfathered nonbank banks.

This bill would make two major changes in these provisions of CEBA. First, it would reduce the QTL 60 percent to 50 percent and make a number of changes in the calculation of the test, with the goal of making it easier for thrifts to meet the percentage requirement. Mr. Chairman, in our opinion, the 60 percent asset test in CEBA is already overly generous. I question just how committed these institutions are to home lending if they are unwilling to devote more than half of their assets to housing activities.

The second major change in this bill would repeal the cross-marketing restrictions in CEBA on diversified thrift holding companies. Mr. Chairman, this would strike at the very heart of CEBA and the separation of banking and commerce.

Who are the diversified thrift holding companies who would benefit from this bill? By definition, a diversified thrift holding company has less than 50 percent of its net worth in thrift activities. These firms are not substantially committed to home lending. Their primary business is in some nonfinancial activity, such as retailing or manufacturing. Last November, the American Banker compiled a list of the top 50 thrift holding companies by asset size. Nos. 2 and 3 were diversified thrift holding companies. Sears was No. 2 and Ford Motor Co. was No. 3. These and many other commercial firms have purchased thrifts and thereby gained access to the payments system and to deposit insurance.

With the deregulation of the early 1980's, thrifts have become more like banks and thus more attractive to commercial firms. The ownership of thrifts by commercial firms raises the very same concerns as the ownership of banks by commercial firms. Both breach the separation of banking and commerce and give the diversified firm a tremendous competitive advantage over fully regulated banks.

Under the Bank Holding Company Act and other laws, banks are subject to policies against excess risk, conflicts of interest, and concentration of resources. These laws are designed to ensure the impartial granting of credit by banks with no direct ownership interest in the borrowers. This bill would undermine these policies.

Repealing the cross-marketing restrictions on these diversified thrifts would give them another competitive advantage over fully regulated banks. A diversified firm which owned a thrift would be able to cross-market all of its other products, from shoes and tires to insurance and securities, to its thrift customers. Likewise, it could cross-sell its thrift products to all of its other customers. Banks have few of these same opportunities.

As this committee knows, a debate is raging over the question of the impact of deregulation on the U.S. Government's safety net. The insolvent FSLIC and the too-big-to-fail policies of the FDIC loom large in this debate, which will carry into the next Congress. That would be the appropriate time to consider if and how this proposal fits into these broader public policy questions.

Mr. Chairman, we are also opposed to provisions in the bill which would increase the commercial lending authority of thrifts. Commercial lending requires an expertise and a credit analysis very different from a home lending situation. It would be a traves-

ty to increase the commercial lending activities of thrifts without requiring them to have the expertise and the capital needed to carry on that business in a safe and a sound manner.

Further, thrift regulators lack the expertise needed to properly supervise expanded commercial lending.

In the early 1980's we tried a "powers" fix for thrifts so that they could diversify out of long-term, low-rate mortgages. Now interest rates are more stable, but large numbers of thrifts that took advantage of the new powers under the Garn-St Germain and State laws are in trouble. More powers are not the solution to the current crisis.

In summary, the problems of the thrift industry are not the result of the thrift charter. In almost every respect, thrifts are subject to fewer restrictions than banks and bank holding companies. They have more lenient capital requirements and accounting standards, liberal lending limits and various tax benefits. The thrift charter already enjoys a number of advantages compared to bank charters.

S. 2073 would enhance those competitive inequities. By further breaching the separation of banking and commerce, it would lead to greater concentration in our financial system.

I appreciate the opportunity of appearing before your committee, Mr. Chairman.

[The complete prepared statement of Mr. Nunn follows:]

T E S T I M O N Y

of

J.R. NUNN

PRESIDENT

OF THE

INDEPENDENT BANKERS ASSOCIATION OF AMERICA

AND

CITIZENS BANK, TUCUMCARI, NEW MEXICO

ON

THE THRIFT CHARTER ENHANCEMENT ACT OF 1988

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFIARS

UNITED STATES SENATE

WEDNESDAY, APRIL 27, 1988

ROOM 538 DIRKSEN SENATE OFFICE BUILDING

WASHINGTON, D.C.

Mr. Chairman and members of the Committee, my name is J.R. Nunn. I am President of the Independent Bankers Association of America and President of Citizens Bank in Tucumcari, New Mexico. The IBAA is the only national trade association that exclusively represents the interests of independent community banks.

I appreciate the opportunity to present our concerns about the bill introduced by Senator Karnes, the Thrift Charter Enhancement Act. There is no question that the thrift industry and the FSLIC fund face very serious challenges. We commend Senator Karnes for his efforts to find ways to recapitalize the industry, but we strongly oppose several parts of his bill.

The serious nature of the thrift problems first became apparent in the early 1980s. The response of Congress was the Garn-St Germain Act of 1982, which gave thrifts certain traditional banking powers, including demand deposit accounts and commercial lending authority.

Unfortunately, those powers were granted without adequate capital or regulatory safeguards. Now, six years later, despite those expanded powers, parts of the thrift industry and the FSLIC fund are in worse shape. A recent Wall Street Journal article argued that the 1982 Act actually contributed to the current crisis. The March 25, 1988 article stated: "Much of the S&L debacle can be traced to the 1982 Garn-St Germain legislation, and subsequent state deregulation, that gave broad and risky new powers to S&Ls. Now, with those problems still unresolved, Congress is contemplating further banking deregulation, the repeal of the Glass Steagall Act that separates commercial and investment banking."

The Karnes bill proposes two basic solutions to the current thrift crisis. First, it would further expand thrift commercial lending authority. Our Association opposed this idea in 1981 and we continue to oppose it today. Second, the bill would attempt to attract more private capital by making it easier for commercial firms to own thrifts. Such a change would aggravate the nonthrift thrift loophole and further breach the separation of banking and commerce.

Just last year, Congress reaffirmed its support for the separation of banking and commerce by closing the nonbank bank loophole in the Competitive Equality Banking Act (CEBA). As you know, former Fed Chairman Paul Volcker strongly argued that it was also essential to close the nonthrift thrift loophole. He stated: "Restrictions on powers of bank holding companies and on nonbank banks will inevitably be undercut, and rapidly, to the extent thrift institutions with banking powers can simply substitute as a vehicle for undertaking a wide range of banking services."

Ford Motor Company's thrift, First Nationwide, recently announced that it would begin opening hundreds of branches in K-Mart stores across the country. This underscores Paul Volcker's argument that to preserve the separation of banking and commerce, nonthrift thrifts should be subject to restrictions similar to

those on nonbank banks. CEBA moved in this direction, although not as far as we and we believe Chairman Volcker had hoped.

In CEBA, the Congress attempted to draw a line between those thrifts which have a substantial commitment to home lending and those which do not. The qualified thrift lender test (QTL) and crossmarketing restrictions were two lines Congress drew. Under the QTL test, the thrift subsidiary of a holding company must devote at least 60% of its assets to housing and related activities. This 60% basket can include investments in loans, equity positions or securities related to residential real estate or manufactured housing. It can also include assets used by the thrift to conduct its business or to facilitate acquisitions or mergers with other thrifts. If it meets the 60% test, the parent holding company can engage in almost any nonbanking activity.

Also, CEBA prohibits a diversified thrift holding company from using its thrift to crossmarket products or services that are not available to a bank holding company. These restrictions are similar to those imposed on grandfathered nonbank banks.

The Karnes bill would make two major changes in these provisions of CEBA. First, it would reduce the QTL 60% assets standard to 50% and make a number of changes in the calculation of the test, with the goal of making it easier for thrifts to meet the percentage requirement. Mr. Chairman, in our opinion, the 60% assets test in CEBA is already overly generous. I question just how committed these institutions are to home lending if they are unwilling to devote more than half of their assets to housing activities.

The second major change in the Karnes bill would repeal the crossmarketing restrictions in CEBA on diversified thrift holding companies. Mr. Chairman, this would strike at the very heart of CEBA and the separation of banking and commerce.

Who are the diversified thrift holding companies who would benefit from the bill? By definition, a diversified thrift holding company has less than 50% of its net worth in thrift activities. These firms are not substantially committed to home lending. Their primary business is in some nonfinancial activity, such as retailing or manufacturing. Last November, the American Banker compiled a list of the top 50 thrift holding companies by asset size. Numbers two and three were diversified thrift holding companies. Sears was number two and Ford Motor Company was number three. These and many other commercial firms have purchased thrifts and thereby gained access to the payments system and deposit insurance.

With the deregulation of the early 1980s, thrifts have become more like banks and thus more attractive to commercial firms. The ownership of thrifts by commercial firms raises the very same concerns as the ownership of banks by commercial firms. Both breach the separation of banking and commerce and give the diversified firm a tremendous competitive advantage over fully regulated banks.

Under the Bank Holding Company Act and other laws, banks are subject to policies against excessive risk, conflicts of interest and concentration of resources. These laws are designed to ensure the impartial granting of credit by banks with no direct ownership interest in the borrowers.

Paul Volcker often cited the danger of having credit decisions made by banks or thrifts which are owned by commercial firms: "Will those banking offices serve the general needs of other borrowers in the local community? Suppose the local appliance dealer comes in there to ask for loans from a bank run by a large retail chain. I suspect that branch manager isn't going to be very happy to provide the money to the local retail establishment. If he does, I suspect he is going to find himself selling shoes instead of running the bank office before very long."

Repealing the crossmarketing restrictions on these diversified thrifts would give them another competitive advantage over fully regulated banks. A diversified firm which owned a thrift would be able to crossmarket all of its other products, from shoes and tires to insurance and securities, to its thrift customers. Likewise, it could cross-sell its thrift products to all of its other customers. Banks have few of these opportunities, since their activities are restricted to those closely related to banking.

As this Committee knows, a debate is raging over the question of the impact of deregulation on the U.S. government's safety net. The insolvent FSLIC and the too-big-to-fail policies of the FDIC loom large in this debate, which will carry into the next Congress. That would be the appropriate time to consider if and how Senator Karnes' proposals fit into these broader public policy questions.

The thrift industry was created to help average families obtain home mortgages, not to be the federal safety net for a Fortune 500 banking network. The problems of the thrift industry are real. The Karnes bill represents one possible solution, by bringing more private capital to the industry. As you know, a number of thrifts have long been owned by commercial firms through the unitary thrift holding company vehicle. However, as thrifts have become more like banks, this ownership relationship now raises the same concerns as the nonbank bank situation.

Mr. Chairman, we are also opposed to provisions in the bill which would increase the commercial lending authority of thrifts. Permitting a thrift to increase its commercial loans from 10% of assets to 20% of assets would be a major encroachment into a traditional commercial banking activity. As a high earning commercial bank, only 20% of my total loans are commercial loans. This represents a little over 8% of my total assets. My loan to assets ratio is a conservative 58% and despite the problems with the economy in the southwest, my bank has 13% capital. A thrift would be considered highly capitalized with 4% capital. 4% capital for a bank would very likely mean an enforcement action from the bank regulators.

Commercial lending is more than simply extending credit to a business. It requires an expertise and a credit analysis very different from a home lending situation. Even in the home lending area, thrifts have encountered problems from grossly mismatched assets and liabilities. It would be a travesty to increase the commercial lending activities of thrifts without requiring them to have the expertise and capital needed to carry on that business in a safe and sound manner. Further, thrift regulators lack the expertise needed to properly supervise expanded commercial lending.

In the early 1980s, we tried a "powers" fix for thrifts so they could diversify out of long term, low rate mortgages. Now, interest rates are more stable, but large numbers of thrifts that took advantage of new powers under Garn-St Germain and state laws are in trouble. More powers are not the solution to the current crisis.

Title III of the bill would amend the Depository Institutions Interlocks Act. The substance of that title has already been incorporated in section 206 of the Proxmire Financial Modernization Act. We appreciate the amendment offered by Senator Karnes during the markup to exclude advisory and honorary directors of small banks. This will make it much easier for many small banks to keep qualified directors involved in their banks. Since this issue was addressed in S.1886, further changes are unnecessary.

In summary, the problems of the thrift industry are not the result of the thrift charter. In almost every respect, thrifts are subject to fewer restrictions than banks and bank holding companies. They have more lenient capital requirements and accounting standards, liberal lending limits and various tax benefits. The thrift charter already enjoys a number of advantages, compared to bank charters.

Senator Karnes' bill would enhance those competitive inequities. By further breaching the separation of banking and commerce, it would lead to greater concentration in our financial system.

Finally, Mr. Chairman, let me briefly mention another issue of great interest to community banks. One of the provisions of S.1886 which concerns us most is the creation of the diversified financial services holding company. It was our understanding that this section was explicitly intended to make it easier for specific securities firms to own a bank as well as keep their other lines of business. I was surprised to read that the Executive Vice President of American Express recently told your Committee that this new ownership structure does not apply to their operations. Given the serious concentration issues raised by this new structure, we would seriously urge you to eliminate this provision in conference.

I appreciate the opportunity to appear today and will be happy to answer any questions you have.

The CHAIRMAN. Thank you very much.

Mr. Koch, you're the first vice chairman of the National Council of Savings Institutions. I presume you're no relation to the mayor of New York.

Mr. KOCH. No, I'm not.

The CHAIRMAN. Well, I know that's a relief for you. [Laughter.]

Go right ahead, sir.

Mr. KOCH. I sometimes wish when I go to that fair city and I see the prices that I could take advantage of some of my shirttail relationships there I think it would work out better.

STATEMENT OF CHARLES JOHN KOCH, FIRST VICE CHAIRMAN, NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

Mr. KOCH. Mr. Chairman and members of the committee: My name is Bud Koch. I'm president and CEO of the First Federal Savings Bank in Cleveland, OH. I am also president of Charter One Financial, which is a newly formed holding company that recently converted from mutual to stock ownership. I might point out that we converted in January and we are the only major thrift that's insured by FSLIC that converted since the crash. And in deference to Chairman Wall, I would point out that timing is everything and since the calendar for converting thrifts appears to be rather small right now post-crash, I suspect that that avenue of capital to our industry has temporarily been eliminated since the stock market crash.

I appear today as first vice chairman of the National Council of Savings Institutions. The National Council is a trade association representing savings banks and savings and loan associations nationwide.

We appreciate your holding hearings at this time on Senator Karnes' bill, S. 2073, the Thrift Charter Enhancement Act of 1988, and we certainly appreciate the opening comments of the members of the committee. We agree that more must be done to solve the thrift problem in the industry and we think that this bill would begin that process.

We commend Senator Karnes for his leadership in sponsoring this bill which is vitally important to our industry. It will, we believe, attract additional capital into the savings and loan industry by making the S&L charter more attractive to outside investors.

It also provides additional incentives for S&L's and other companies to acquire failing institutions.

SUPPORT FOR S. 2073

Therefore, the National Council enthusiastically endorses S. 2073 and urges the approval of it by the committee.

We understand Chairman Proxmire's concerns about further powers for thrifts, but we feel that it's time to recognize that the healthy part of the industry needs help also. If we don't do something for the healthy part of the industry, unfortunately, that part of it may very likely sink into the quagmire in which 10 percent of assets or roughly a third of the members of the thrift industry currently reside. We just simply cannot continue to ignore the healthy part of the industry.

84-991 0 - 88 - 3

The $10.8 billion FSLIC recap bill enacted last year must be supplemented by outside capital if the industry's problems are to be satisfactorily resolved. Dollars attracted from outside the industry for the acquisition of a troubled S&L obviously represent dollars that the FSLIC can deploy to solve additional problem cases. We believe that this bill will attract such funds.

Most of the provisions in the Karnes bill amend the Savings and Loan Holding Company Act, which has not had a thorough review since 1968. That act was purposefully drafted with extensive protections insulating the S&L in the holding company and its depositors from risks incurred by the holding company parent and by the holding company's non-S&L affiliates. These protections have stood the test of time very well. In practice, however, several of these restrictions have proven to be narrower than required for the protection of the institutions and have had unintended consequences.

Title I of the bill would expand commercial lending authority for federally chartered S&L's from 10 to 20 percent of assets for associations that meet their reserve requirements. It would increase the permissible service corporation investments from 3 to 5 percent of assets with an additional 5 percent permitted for institutions that acquire failing institutions.

It is important to note that this bill provides increased powers only to well-capitalized thrifts. We applaud this section of the bill since we think that it's time to start to swing the emphasis to a risk-based insurance system, one that rewards the well-capitalized institutions and possibly limits the activities of the poorly capitalized institutions. This bill starts that process.

I might point out that recent Federal Home Loan Bank Board proposals to phase down the special assessment also is in line with the risk-based premium type concept and we also enthusiastically endorse that proposal.

Amendments would make the Federal charter somewhat more attractive than it is at present, but as it has been pointed out earlier in the hearing and I would point out again, that in many cases all that we're doing with this bill is bringing it closer to the provisions that are already available in many, many States throughout the country. This somewhat levels the playing field for federally chartered institutions.

CONFLICT OF INTEREST REGULATIONS

Section 211 of the bill requires FSLIC to make a major change in the conflict of interest regulations and conform them with applicable commercial banking regulations. The S&L and banking conflict regulations are similar in their coverage but a relatively minor transaction between an association and an affiliated person under the FSLIC regulations triggers a requirement to file a lengthy and detailed disclosure document, form AR, which we believe is of little practical value. Conflicts for transactions with affiliates regulations applicable to commercial banks places strict limits on aggregate loans to insiders and affiliates and imposes a straightforward requirement that such transactions be arm's length in nature.

We believe that the commercial bank regulations on this subject have worked well and that their extension to FSLIC insured insti-

tutions would eliminate needless paperwork for FSLIC chartered companies.

The remainder of title II of the bill deals primarily with proposed amendments to the S&L Holding Company Act. As I noted earlier, we believe these amendments would not compromise the principles of safe and sound operation but would remove some needless restrictive provisions of the act that in our opinion are substantial disincentives for the acquisition of S&L's by outside companies.

The major changes the bill proposes to the S&L Holding Company Act are: (1) repeal the statutory debt approval requirements; (2) repeal of interlock provisions and cross-marketing restrictions; (3) limits on net worth maintenance agreements; (4) modifications to the qualified thrift lender or QTL test and a revision of the definition of "subsidiaries" to make it clear that the act does not empower the Bank Board to restrict the activities of direct subsidiaries of S&L's or savings banks in a multiple S&L holding company.

Bank holding companies are not subject to debt approval or separate interlock restrictions, therefore we see no reason why S&L holding companies should be subject to these restrictions. We think that cross-marketing restrictions enacted by CEBA are justified neither by experience nor by common sense. Bank and thrift customers are protected from abusive marketing practices by restrictions in the banking laws, including those enacted by the S&L Holding Company Act's Section 104 of CEBA. That provision prohibits institutions from tying or conditioning the providing of one product to the service or acceptance of another product.

The bill's recommendation on net worth maintenance agreements would limit their duration to 3 years unless the Bank Board—and this is an important provision—unless the Bank Board finds that the terms of the original agreement are not being met. These agreements constitute a substantial disincentive for outside interests to acquire troubled thrifts, particularly since the possible liability of the acquiring company of such institutions is virtually unlimited.

The bill also limits restrictions on de novo institutions to 3 years. Given the trend that we have noted of industry consolidation for the last several years, it seems to us that the removing of the restriction on de novos would tend to increase the number of de novo institutions being chartered and in fact would tend to counterbalance that consolidation that we're seeing in the industry.

The proposed amendments to the QTL test are quite modest, but we believe they will be of assistance to S&L's in areas where housing is low or in times when housing demand for mortgages is somewhat low, as we are seeing really today.

The QTL test requires an institution have at least 60 percent of its investments in qualified assets, basically mortgage loans. Qualified assets also include liquidity investments and one-half of the amount of mortgage loans originated and sold in the secondary market within 90 days. The amount of these investments that can be counted as qualified assets, however, is limited to only 10 percent of the institution's assets. We believe that the QTL test unjustifiably discriminates against mortgage loans originated and sold within 90 days and we would rather see this opened up somewhat as proposed by the bill.

Section 201 of the bill is simply designed to assure that the limits placed on activities of multiple savings and loan holding companies by the S&L Holding Company Act are not applied to limit the activities granted by state law to service corporations of State-chartered S&L's in the holding company format.

Title III proposes two exceptions to the Depository Institutions Management Interlocks Act which was passed by Congress in 1978.

First it would create exceptions to the provision in the Interlocks Act where a company that became a depository institution holding company as a result of acquiring a failing institution, again making it more attractive for outside capital to come into the industry.

The second provides exceptions for interlocks that are not found to be anticompetitive.

Mr. Chairman, this concludes my remarks and I would be happy to answer questions later.

[The complete prepared statement of Mr. Koch follows:]

84-991 O - 88 - 4

Statement of

Charles John Koch
on behalf of the
National Council of Savings Institutions

before the

Committee on Banking, Housing and Urban Affairs
United States Senate

on

S. 2073, the "Thrift Charter Enhancement Act of 1988"

Room 538 - Dirksen Senate Office Building

10:00 a.m.

April 27, 1988

Mr. Chairman and Members of the Committee, my name is Charles John Koch, and I am President and CEO of The First Federal Savings Bank in Cleveland, Ohio. I appear today as First Vice Chairman of the National Council of Savings Institutions. The National Council is a trade association representing savings banks and savings and loan associations nationwide.

Mr. Chairman, this may be the National Council's last appearance before this Committee under your Chairmanship. Noting your intention to retire at the conclusion of this Congress, we would like to express our appreciation for your long and constructive service in the Senate and as Chairman of this Committee. Many milestones in banking law were enacted under your leadership. We did not always agree on these issues, but our differences were ones of means of improving the ability of the thrift industry to serve the public, rather than ones relating to our mutual commitment to this goal.

We appreciate your holding hearings at this time on Senator Karnes' bill, S. 2073, the "Thrift Charter Enhancement Act of 1988" so soon after the completion of action on S. 1886, the "Proxmire Financial Modernization Act of 1988".

We also commend Senator Karnes for his leadership in sponsoring this bill which is vitally important to the thrift industry. It is a critical supplement to the Competitive Equality Banking Act of 1987 (CEBA), enacted last year, which recapitalized the Federal Savings and Loan Insurance Corporation. The Karnes bill, we believe, will attract additional capital into the savings and loan industry by making the S&L charter more attractive to outside investors. It also provides additional incentives for S&Ls and other companies to acquire failing thrift institutions.

The National Council enthusiastically endorses S. 2073 and urges its approval by the Committee.

The $10.8 billion FSLIC recapitalization plan, enacted last year, must be supplemented by outside capital if the industry's problems are to be satisfactorily resolved. Dollars attracted from outside the industry for the acquisition of a troubled S&L obviously represent dollars that the FSLIC can deploy to additional problem cases. We believe that the Karnes bill will attract such funds.

Most of the provisions in the Karnes bill amend the Savings and Loan Holding Company Act, ("S&L Holding Company Act"), which has not had a thorough review since its enactment in 1968. That Act was purposefully drafted with extensive protections insulating the S&L in the holding company and its depositors from risks incurred by the holding company parent and by the holding company's non-S&L affiliates. These protections have stood the test of time very well. In practice, however, several of these restrictions have proven to be narrower than required for the protection of the institution or have had unintended consequences.

Several proposals in the Karnes bill would modify amendments that were made to the S&L Holding Company Act by CEBA. We realize that CEBA was enacted less than a year ago, but we believe that as the Committee carefully considers these sections of that Act as they would be amended by 2073, it will conclude that these changes are warranted.

Specifically, S. 2073 would make the savings and loan charter more attractive by:

- expanding the powers of Federally-chartered S&Ls in a prudent manner;
- substituting transactions with affiliates regulations applicable to commercial banks for the needlessly cumbersome conflicts regulations currently imposed on FSLIC-insured institutions;
- requiring restrictions on newly-chartered associations to be removed within a set period of time;
- removing outmoded restrictions in the Savings and Loan Holding Company Act; and
- deleting unnecessary restrictions on interlocks of directors and officers of S&Ls and other depository institutions.

The bill also provides incentives for healthy S&Ls and S&L holding companies to acquire failing institutions.

State of the Industry

Before discussing the details of the bill, I would like to put the capital needs of the savings and loan industry in perspective.

As of the end of 1987, there were 3,147 FSLIC-insured institutions with about $1.25 trillion in assets. The average size of these institutions was almost $400 million and the median size was about $100 million. The top ten percent of the institutions collectively controlled almost 70 percent of industry assets.

Savings and loan assets grew $88 billion or 7.5 percent in 1987. Deposits grew only $42 billion, but FHLBank advances and other types of borrowing provided the S&Ls with alternative sources of funding. Despite the weak deposit growth, the industry continued its support of the mortgage market, increasing its holdings of mortgage loans (including mortgage-backed securities) by almost $68 billion. The increase in mortgage holdings is only part of the story, however, since FSLIC institutions originated over $253 billion in mortgages in 1987, down only slightly from the record 1986 pace.

In 1987, capital measured in accordance with generally accepted accounting principles ("GAAP") for all FSLIC-insured institutions declined as a percentage of total assets for the second consecutive year as shown in Table I.

Table I

Ratio of GAAP Capital to Total Assets
For All FSLIC-Insured Institutions

Year	Percent
1980	5.26
1981	4.15
1982	2.95
1983	3.14
1984	2.87
1985	3.39
1986	3.34
1987	2.82

Source: FHLBB data as processed by National Council

The distribution of GAAP capital ratios among FSLIC-insured institutions is shown in Table II.

Table II

Distribution of GAAP Capital Ratios For
All FSLIC-Insured Institutions, 1987

Capital Range	# of Institutions	% of Institutions
Less than 0%	506	16.1
0% - 3%	435	13.8
3% - 4%	312	9.9
4% - 5%	352	11.2
5% - 6%	350	11.1
6% - 7%	321	10.2
7% and over	871	27.7
Total	3,417	100%

Source: FHLBB data as processed by National Council

Preliminary data for year-end 1987 indicates that savings and loan associations lost $7.0 billion last year, a return on assets of -.59 percent. The losses were concentrated in the lowest tier of institutions, with failed or GAAP-insolvent institutions losing almost $11 billion while the solvent institutions earned almost $4 billion. Over two-thirds of the institutions were profitable in 1987. The losses lowered the industry's regulatory capital to $47.5 billion (3.8 percent of assets) from $52.3 billion (4.5 percent of assets), despite significant issuance of new stock.

One-third of the industry, therefore, is losing capital faster than it is being accumulated by the profitable two-thirds. This stark fact underscores the point that outside capital must be attracted to this industry. The Karnes bill, we believe, will greatly assist the industry in attracting these funds.

Major Provisions of S. 2073

I Expansion of Powers of Federally-Chartered Savings and Loan Associations

A. Service Corporations and Commercial Loans

Sections 101 and 102 of Title I of the bill would expand the commercial loan and service corporation investment authority of Federal associations. Commercial loan authority would be increased from ten to twenty percent of assets for associations that maintain reserves required by the Federal Home Loan Bank Board for three of the four preceding calendar quarters. The permissible service corporation investment would be increased from three to five precent of assets with the investment over four percent required to be used for inner city and community development purposes. An additional five percent of assets could be invested in such corporations for any permissible purpose by associations which acquire a failing institution directly or through a holding company under the emergency provisions of the National Housing Act (NHA)*.

B. Small Business Investment Companies

Section 103 would expand the authority of a Federal S&L to invest in Small Business Investment Companies. The amount of the investment would be limited to the greater of one percent of assets or five percent of capital surplus.

Service corporation activities and commercial lending have proven to be profitable activities for Federal associations and we believe that a modest expansion of these powers for healthy institutions is warranted and will, along with the proposed expanded SBIC investment authority, make the Federal charter even more attractive than it is at present.

---

* References to the "emergency provisions of the National Housing Act" in this testimony mean acquisitions under sections 406(f) and 408(m) of that Act, both of which were created by the Garn-St Germain Act of 1982. Section 406(f) authorizes the FSLIC to provide financial assistance to FSLIC-insured institutions that agree to acquire an institution in default by purchase and assumption. Section 408(m) authorizes the FSLIC to arrange for mergers and acquisitions -- across industry and state lines if necessary -- of failing FSLIC-insured institutions.

II Conflicts of Interest

Section 212 of the bill would require the FSLIC to rewrite its conflicts of interest regulations to conform to those applicable to commercial banks. The current regulations by the FSLIC and the banking agencies dealing with transactions between the institution and "affiliated persons", including companies in which such persons are involved, are similar in purpose but differ significantly in their scope. Relatively minor transactions between an FSLIC-insured institution and its affiliated persons can trigger the filing of a lengthy, detailed disclosure document, Form AR, which we believe is of little use in ensuring that such persons do not abuse the privilege of being an officer, director, or employee of the institution.

The bank regulations on this subject are comprehensive in their coverage of affiliated persons, "insiders", companies they control, and companies controlled by the bank, but there is no equivalent of Form AR. The limits on aggregate loans and other transactions are straightforward, and the general standard for such transactions requires that they be made on an arm's length basis.

These regulations, primarily Sections 22(h), 23A and 23B of the Federal Reserve Act, that are extended to FDIC-insured nonmember banks by Section 18(j) of the FDIC Act, have proven to be effective deterrents to abuse by bank officials of their position with the bank and we support the proposal to substitute them for the current FSLIC regulations.

The adoption by the FSLIC of these regulations would be consistent with crossover provisions in CEBA that permit certain S&L holding companies to be covered by Sections 23A and 23B in their dealings with affiliates, rather than by the more restrictive provisions of Section 408(d) of the NHA and to allow certain FDIC-insured savings banks to elect to be treated as subsidiaries of an S&L holding company.

This movement in the direction of the bank regulations should also encourage the Bank Board to end its practice of applying its general conflicts of interest regulations to S&L holding companies. Because of this policy, S&L holding companies are presently subject to overlapping and duplicate sets of conflicts rules.

III Limitations on De Novo Associations

Under existing law there is no limit the type or the duration of conditions and policies that the Bank Board can impose on newly-chartered and insured savings and loan associations and their directors and officers.

We understand that many of the unnecessarily restrictive conditions have been modified in the past few months, but others remain. One of the most difficult for newly-chartered institutions is one which restricts the interest rate paid on deposits to the average rate prevailing during the preceding quarter in the Federal Home Loan Bank District in which the S&L is located. This condition creates problems for institutions in large cities in the Bank District where rates would tend to be higher than the District average, or during periods in which rates are rising.

Section 104 proposes that if a de novo association during the first three years of its operations operates in substantial compliance with whatever conditions are initially imposed, the conditions will lapse and the association would be able to operate like any other institution insured by the FSLIC.

IV Amendments to the Savings and Loan Holding Company Act

Title II of S. 2073 proposes amendments to remove restrictions in the Savings and Loan Holding Company Act that do not compromise principles of safety and soundness. They range in scope from structural changes in the Act to relatively narrow technical amendments. Also included are amendments proposing incentives for holding companies to acquire failing institutions, and amendments relating to mutual holding companies.

A. Structural Amendments to the S&L Holding Company Act

Amendments in this category would repeal the debt approval procedures, the officer and director interlock provisions of the Act, CEBA's cross-marketing restrictions and the net worth maintenance practices of the FSLIC. They would also modify the qualified thrift lender test enacted by CEBA.

1. Debt Approval. Section 210 would repeal Section 408(g) of the NHA, which requires that nondiversified S&L holding companies obtain FSLIC approval prior to incurring debt in excess of 15 percent of their consolidated net worth. This procedure was enacted as part of the 1968 S&L Holding Company Act. Such control was considered necessary at that time because the Bank Board's power to enforce its regulations and orders and its power to remove officers and directors were not as broad as they are today. These enforcement powers have been considerably strengthened since then, particularly by the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (the 1978 Banking Act), and there is no longer any need, in our opinion, for the debt approval provisions in the Act.

The requirement in Section 410(b) of CEBA that a holding company debt application be deemed to be approved if the Bank Board has not acted on it in 60 days is little help to companies desiring to issue debt under a short deadline in order to take advantage of favorable market conditions.

We commend the Bank Board for the blanket debt approval provision of section 584.6 of the FSLIC regulations. We would prefer, however, that the need for such a regulation with its complex set of qualifications and exceptions be eliminated.

Bank holding companies are not subject to debt approval requirements and repeal of Section 408(g) would place S&L holding companies on a par with these companies with respect to their ability to raise capital in an expeditious manner.

2. Holding Company Interlocks. Section 408(i) of the NHA in part prohibits a director, officer or controlling person of an S&L holding company or its subsidiaries from serving, without approval of the FSLIC, in a similar capacity with another S&L, or S&L holding company, or from acquiring control of another S&L outside the holding company.

Section 205 of the bill would repeal these interlock provisions of Section 408(i).

We believe that this action is warranted because savings and loan holding companies are also subject to the restrictions of the Depository Institutions Management Interlocks Act, which was enacted as Title II of the 1978 Banking Act. As with conflicts of interest regulations, there is no need for S&L holding companies, in our opinion, to be subject to duplicate sets of interlock restrictions.

3. Cross-Marketing Restrictions. Section 104(d) of CEBA prohibits the cross-marketing between a bank or S&L in a holding company and its holding company affiliates of products and services other than those that are permissible under Section 4(c)(8) of the Bank Holding Company Act or those that were being offered as of March 7, 1987. Section 4(c)(8) authorizes the Federal Reserve Board to allow bank holding companies to engage in nonbanking activities that it finds to be so "closely related" to banking as to be a "proper incident thereto". Section 207 of S. 2073 would repeal these cross-marketing restrictions.

We believe that these cross-marketing restrictions are not justified by either experience or common sense. Bank customers are protected from abusive marketing practices by provisions in the banking laws that banks may not "tie", or condition, the providing of one banking service on the acceptance by the customer of another service. This principle is also incorporated into the general antitrust laws.

4. Net Worth Maintenance. Section 211 of the bill would place a three-year time limit on the net worth maintenance agreements that the Federal Home Loan Bank Board frequently imposes on S&L holding companies that acquire an S&L as a condition of the approval of the acquisition.

These agreements require the holding company to guarantee the maintenance by the thrift of a specified level of net worth for an indefinite period of time. These agreements are a significant disincentive to the acquisition of troubled thrifts, particularly, since the possible liability of the acquiring company is virtually unlimited.

In addition, the Bank Board authority to set individual capital requirements on a case-by-case basis, in section 563.14 of the FSLIC regulations, makes the potential level of liability under such agreements even less predictable than it would be otherwise.

Section 211 provides that these agreements would expire at the end of three years, but only if the Bank Board found that the thrift had complied with applicable net worth requirements in three out of the four preceding fiscal quarters and was not engaged in any unsafe or unsound practices. If these conditions were not met, the Bank Board could extend

the agreement until the thrift is in compliance. By so providing, the section seeks to balance the need for adequate net worth and safe practices on the part of individual thrift institutions with the desirability of removing serious obstacles to thrift acquisitions.

5. The Qualified Thrift Lender Test. Section 104(c) of CEBA provides that, subject to certain grandfathering provisions, a unitary S&L holding company is limited to activities permitted for a multiple S&L holding company under Section 408(c)(2) of the National Housing Act unless the S&L subsidiary meets a "qualified thrift lender" ("QTL") test set out in that section.

The QTL test requires that the S&L must hold at least 60 percent of its tangible assets in "qualified thrift investments" ("qualified assets") which are essentially mortgage loans and other housing related investments, assets which meet the liquidity requirements of the Federal Home Loan Bank Act and 50 percent of the dollar amount of residential mortgage loans originated and sold within 90 days.

The amount of liquidity and loan origination investments that can count as qualified assets, however, is limited to an amount equal to 10 percent of the institution's tangible assets.

While the goal of the QTL test is to provide an incentive for S&L associations to continue their historic role as major providers of housing finance in this country, we believe that it is unduly restrictive. Not only is the demand for mortgage credit weak in many parts of the country, the competition for mortgage originations has intensified significantly during the past decade. Securities firms, commercial banks, and even automobile credit companies have formed mortgage banking subsidiaries in recent years. General Motors Acceptance Corporation, in fact, is among the largest, if not the largest, mortgage banking company in the country.

The amendments to the QTL test proposed by Section 206 of S. 2073 are quite modest but we believe that they provide needed flexibility for S&L associations to engage in a significant amount of mortgage lending in highly competitive markets without losing their QTL status. Most importantly, the amendments permit 100% rather than 50% of loans originated and sold within ninety days to count as qualified assets within the 10 percent basket.

We do not believe that the penalty in the QTL test on loans originated and sold within 90 days is justified. Such a loan fulfills the purpose of the QTL test, i.e., providing a source of funds for housing, just as well as a loan which the institution buys from another originator and holds in portfolio, or a loan which it originated itself and holds in portfolio for more than 90 days.

Certainly there are times, as this Committee is well aware, when an insured institution is well-advised to reduce its mortgage portfolio, particularly its fixed rate loans, without necessarily curtailing originations.

The other proposed amendments to the test would: (a) phase in over a three-year period a reduction in the percentage of tangible assets that must be held in qualified thrift investments from 60 percent to 50 percent; (b) include qualified liquidity investments of an S&L's subsidiary as part of its qualified assets; (c) remove liquidity from the 10 percent basket so that all of the liquidity of the institution and its subsidiary will be qualified investments under the 60 percent requirement; and (d) expand the scope of liquid assets for purposes of the QTL test to include assets held for protection against interest rate swings as well as those designed to assure liquidity.

B. Technical Amendments to the S&L Holding Company Act

These amendments relate to the interpretation of "subsidiaries" under Section 408(a) of the National Housing Act, the restrictions on investments in stock of nonaffiliated S&Ls and the quantitative limits on certain transactions with affiliates.

1. Definition of Subsidiaries. Section 201 of the bill is designed to correct an unintended restriction in Section 408(c) of the National Housing Act relating to activities of multiple S&L holding companies. That section lists activities that are permitted for such holding companies and their non-S&L "subsidiaries". The Federal Home Loan Bank Board since 1973, has interpreted the term "subsidiaries" to include service corporation subsidiaries of state-chartered S&Ls in multiple holding companies and has limited their activities to those permissible for service corporation subsidiaries of Federally-chartered S&Ls to the extent that they have independent legal power to engage in such activities.

Section 201 would amend the definition of "affiliates" in Section 408(a)(1)(H) of the National Housing Act to make it clear that the activities restrictions imposed on multiple S&L holding companies by Section 408(c)(2) of the NHA do not apply to a service corporation subsidiary (or its subsidiaries) of a state-chartered S&L that is part of that holding company.

We support Section 201, but believe that it should be broadened to include certain other subsidiaries that are not technically S&L service corporations. The 1978 Banking Act authorized the Federal Home Loan Bank Board to grant Federal charters to authorized state-chartered FSLIC-insured savings banks. These FSBs may retain their FDIC insurance or apply for FSLIC insurance. In either case, most investment powers authorized for those institutions by state law, including leeway investment authority, are grandfathered. Many of these institutions use part or all of this authority to invest in subsidiaries which engage in activities not necessarily permissible for service corporations of either state- or Federally-chartered S&Ls.

In addition, Section 104(f) of CEBA provides that state-chartered FDIC-insured savings banks that meet the QTL test can elect to be owned by an S&L holding company and be treated as S&Ls for purposes of the S&L Holding Company Act. These institutions can also be expected to own "leeway subsidiaries" that would not qualify as a service corporation under

Bank Board regulations or under the NHA as it would be amended by Section 201 of the bill.

We strongly believe that both Federal and state-chartered savings banks should not lose the right to engage in activities conferred by state law simply because they elect to become subsidiaries of S&L holding companies or to convert to Federal charter.

We therefore suggest the following change to the proposed amendment in Section 201 to clarify that the NHA does not subject leeway subsidiaries to savings banks to the limitations imposed on multiple S&L holding companies. The new amendment would read as follows (new language underlined):

> "(H) 'Subsidiary' of a person means any company which is controlled by such person, or by a company which is a subsidiary of such person by virtue of this subsection except that for purposes of paragraphs (1), (2), (4) and (6) of subsection (c) of this section the term 'subsidiary' does not include: (i) a service corporation subsidiary of an insured institution or any subsidiary of such service corporation; (ii) a subsidiary of a Federal savings bank chartered in accordance with section 5(i) or 5(o) of the Home Owners' Loan Act of 1933, if such subsidiary is established pursuant to state law; or (iii) a subsidiary established pursuant to state law of an institution that is deemed to be an insured institution under subsection (n) of this section."

2. **Transactions With Affiliates.** Among the provisions on transactions with affiliates in Section 408(d) of the National Housing Act are several that are limited in amount to the lesser of $100,000 or one-tenth of one percent of the institution's total assets at the end of the preceding fiscal year, unless a greater amount is approved by the FSLIC.

These transactions involve the sale or lease of property other than mortgages, and the furnishing of management consulting and other services.

Section 203 of the bill would amend these restrictions to be the greater of these two figures.

Under present law, a $1 billion institution conducting these transactions would be limited to $100,000 each, since $100,000 is lower than one-tenth of one percent of its assets, which is $1 million. Present law, in fact, limits all institutions of over $100 million in assets to the $100,000 amount. This is an outmoded restriction considering the growth of institutions since the S&L Holding Company Act was passed in 1968. Under the amendment in Section 208 of the bill, the upper limit for a $1 billion institution would be .1 percent of assets or $1 million. We do not believe this is an unwarranted amount in view of the size of the institution.

3. **Purchase of Stock in Unaffiliated Savings and Loan Associations.** Section 204 of the bill would amend Section 408(e) of the National Housing Act to permit unitary S&L holding companies to acquire up

to 5 percent of the voting stock of any FSLIC-insured institution or its holding company.

This would put such holding companies on a par with bank holding companies, which under Section 3(a)(3) of the Bank Holding Company Act may acquire up to 5 percent of the voting shares of any bank.

Many S&L holding companies desire to own a nominal number of shares of other S&L holding companies or S&Ls in order to receive annual reports, proxy statements and similar documents, and because there are times when such purchases are a good investment. S&L holding companies can purchase stock in FDIC-insured banks and we see no reason why this kind of purchase, far short of control, should continue to be prohibited for S&L holding companies.

Consistent with the fact that some savings and loan holding companies engage in securities activities, the amendment also provides that the 5 percent limit does not apply to securities held by a holding company securities affiliate as inventory, for the purpose of market making or for other purposes in the normal course of its business.

C. Incentives for Insured Institutions to Acquire Failing Thrifts

Two amendments in Title II of S. 2073 would provide added incentives for S&L holding companies to acquire problem institutions.

1. **Unitary Holding Company Treatment.** Section 104(b) of CEBA amended Section 408(c) of the National Housing Act to restrict activities of S&L holding companies, subject to grandfathering provisions, to those activities formerly available to multiple S&L holding companies and to nonbanking activities that the Federal Reserve Board has determined to be permissible under Section 4(c)(8) of the Bank Holding Company Act.

There are two exceptions to this restriction. A unitary S&L holding company is subject to these limits if its S&L meets the QTL test. A multiple S&L holding company with no more than one "healthy" institution that acquires one or more problem S&Ls may also be treated as a unitary holding company if all of its S&L subsidiaries meet the QTL test.

Section 202 of the bill would provide an added incentive for a holding company to acquire a failing S&L under the emergency provisions of the NHA by broadening the multiple holding company exception to increase the permissible number of healthy associations in the holding company from one to two.

2. **Transactions With Affiliates.** Section 104(d) of CEBA added a new subsection (p)(1) to Section 408 of the NHA providing that savings and loan holding companies that confine their activities to those permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act will be subject to the transactions with affiliates rule applicable to bank holding companies under Sections 23A and 23B of the Federal Reserve Act, rather than the more restrictive rules applicable to S&L holding companies in Section 408(d) of the NHA.

Section 208 of S. 2073 provides that an S&L holding company that acquires a failing institution under the emergency provisions of the NHA may also elect to be subject to the bank rules irrespective of the other ctivities in which it is engaged.

D. Mutual Holding Companies

Section 209 of the bill would "fine tune" the mutual holding company provisions of Section 408(a) of the National Housing Act.

The National Council has long supported legislation that would permit mutual institutions to do business in holding company form. One of the reasons for this policy is the premise that a mutual institution should not be forced to convert to a stock form of ownership in order to obtain the advantages of the holding company format. Congress recognized the merits of this approach by enacting Section 107 of CEBA, which adds a new subsection (s) to Section 408 of the NHA authorizing the FSLIC to permit FSLIC-insured mutual institutions to form mutual holding companies.

In essence, the holding company is formed by having the mutual institution charter an interim stock savings institution. The mutual institution would become the holding company parent by transferring its assets and liabilities to the interim institution in return for the stock of that institution.

Section 209 of the bill would amend Section 408(s) to: (a) make it clear that a mutual holding company can acquire a stock institution insured by FSLIC, and (b) empower the S&L subsidiary of a mutual holding company to issue to the public up to 49 percent of the outstanding shares of its common stock.

The issuance of a portion of the stock of the bank subsidiary of the first mutual holding company approved under state law was permitted by the Banking Commissioner of Connecticut on October 20, 1980. The order approved the formation of a mutual holding company by People's Bank, Bridgeport, Connecticut. The application was approved under the Bank Holding Company Act by the Federal Reserve Board on September 2, 1987.

The Council believes that it would be beneficial for institutions contemplating the formation of a mutual holding company to be able to raise equity capital in manageable amounts so long as the amount of stock sold does not exceed 49 percent of the total outstanding shares. This provision would enable the holding company subsidiary to raise capital as needed — up to the percentage limit — while retaining the benefits of mutual ownership.

V Director and Officer Interlocks

Title III of S. 2073 proposes two amendments to the Depository Institutions Management Interlocks Act relating to acquisitions of problem institutions.

Section 301 would add new subsections (7) and (8) to Section 205 of the Act.

Section 205 currently provides six exceptions to Sections 203 and 204 of the Act which prohibit certain interlocks of officials of depository institutions which are located in the same geographic area or which exceed a certain size irrespective of location.

Section 203 of the Act bars interlocks of "management officials" (generally directors, officers, employees) between unaffiliated depository institutions and their holding companies, if any of their offices are located in the same standard metropolitan statistical area or "city, town or village".

Section 204 prohibits interlocks between a depository institution or holding company with assets of $1 billion or any of its affiliates and an unaffiliated depository institution or holding company with assets of more than $500 million or its affiliates wherever these entities are located.

The present exemptions in Section 205 exclude from these prohibitions depository institutions such as foreign corporations, and Federal Home Loan Banks, which the Act was not intended to cover, and institutions in receivership, or liquidation.

New subsection (7) provides that a company that becomes a depository institution or holding company as a result of acquiring a troubled institution under the provisions of Sections 408(m) of the NHA would be exempt from the interlock restrictions of Sections 203 and 204.

The prohibitions in Section 204 of the Interlocks Act are particularly troublesome in acquisitions of healthy as well as troubled institutions not only because of the increasing number of institutions and holding companies that are growing beyond these asset ceilings, but also because the prohibited interlocks extend to affiliates of depository institutions and their holding companies.

Thus, a manufacturing company that wished to acquire a failing S&L could not do so if the resulting holding company had more than $1 billion in assets and a director of an affiliate of the manufacturing company were also a director of an affiliate of an unrelated S&L — or the S&L itself — if that S&L had more than $500 million in assets. The two affiliates could be thousands of miles apart and be engaged in activities completely unrelated to each other and to activities of depository institutions, but the interlock between them would prevent the S&L acquisition.

We do not believe that Congress intended the Interlocks Act to reach interlocks that neither pose a threat to competition nor create conflicts of interest among financial institutions and their holding companies. New subsection (8) provides that depository institution interlocks would be permissible unless the Federal banking regulator or regulators make a determination that the interlock would be anti-competitive or would lead to a substantial conflict of interest.

While we would support the approach of general exemptions from the Interlocks Act, we believe it would be more feasible to amend this proposed subsection to provide that an interlock that is otherwise impermissible

under the Act will be allowed if the appropriate Federal regulator finds that the interlock is not anti-competitive and does not result in a substantial conflict of interest.

Accordingly, we suggest that the new subsection 205(8) of the Interlocks Act that is proposed by Section 301 of the bill read as follows:

> "(8) Any depository institution, depository holding company or affiliate thereof, if the Federal regulator of such institution or holding company, as set out in section 207, determines within sixty days after notice that the interlocking services of a management official with a nonaffiliated depository institution, depository holding company or affiliate thereof would not result in a monopoly or substantial lessening of competition, and would not lead to substantial conflicts of interest, or if the Federal regulator of the nonaffiliated entity, if different from the Federal regulator of the notifying entity, makes a similar determination.".

Mr. Chairman, we appreciate the opportunity to present our views on S. 2073. We believe that it offers constructive proposals for attracting capital to the savings and loan industry. This approach which would make the FSLIC-insured savings and loan association a more attractive institution and provides a far more effective means for recovery than a moratorium on conversions to FDIC insurance. The latter simply freezes institutions in place and stifles innovation. We therefore urge the Committee to approve the bill with the recommended amendments as soon as possible.

The CHAIRMAN. Thank you very much, Mr. Koch.

Mr. Cooper is the director of the Association of Thrift Holding Companies and we're happy to have you, sir. Go ahead.

STATEMENT OF WILLIAM A. COOPER, DIRECTOR, ASSOCIATION OF THRIFT HOLDING COMPANIES

Mr. COOPER. Thank you. Good morning.

Mr. Chairman and members of the committee: My name is Bill Cooper and I'm chairman and CEO of TCF Financial Corp., Minneapolis, MN. Thank you for asking the Association of Thrift Holding Companies to comment on The Thrift Charter Enhancement Act of 1988.

My company, TCF Financial Corp., is a savings and loan holding company with headquarters in Minneapolis. We have two insured subsidiaries, TCF Banking in Minneapolis with $5.6 billion in assets, and TCF Banc Savings in Texas with assets of $100 million. We also have 12 branches in Chicago, IL. We are the largest thrift in Minnesota and the 25th largest thrift in the country.

We have $150 million of generally accepted accounting principle equity and we are profitable. We earned $5 million the first quarter.

The Association of Thrift Holding Companies represents some 40 companies with assets ranging from $50 million to over $20 billion.

Thrift holding companies, which have grown in number from 44 at the beginning of 1960 to more than 350 today, are companies which control a thrift subsidiary and often a variety of other kinds of businesses.

Our Association believes the holding company form represents the future in the thrift industry, and a review of the industry trends will demonstrate this fact. Thrift holding companies generally are a source of capital and management to the savings and loan industry.

ELIMINATE REGULATORY RESTRAINTS

Our Association strongly supports the legislation you have before you today. The intent of this legislation is to eliminate needless regulatory restraints upon the operations of thrift institutions while maintaining needed safeguards to insure safety and soundness. Mr. Chairman and members of the committee, I cannot convey to you in the time allotted the numerous occasions upon which our Association has found itself hamstrung by Federal regulations which have no rational connection to concerns about safety and soundness. We need desperately to be allowed to be profitable—as does the rest of the industry. We submit that anything the Congress can do to permit us to be profitable, to enhance the value of our charter, while not adversely affecting safety and soundness, it should do. And that is the intent of the bill before you. There are currently a number of statutory and regulatory constraints that we believe can be eliminated or modified without adversely affecting safety and soundness while improving our ability to function in a more efficient fashion.

I would like to comment on just a few of those, many of them have been commented on already.

First is the debt restrictions. Current regulations require us to file something called an H-G any time our holding company wishes to borrow money. We have to wait some 60 days for approval before we're permitted to borrow that money. No one can tell us as to what safety or soundness concern is behind this existing requirement, including the people at the Federal Home Loan Bank. I might point out that our savings and loan association with a phone call can raise hundreds of millions of dollars without anybody's approval.

Section 212, affiliates transactions, limits the transactions between the affiliates of our savings and loan holding company and the other subsidiaries. In many cases this regulation results in absurd results. For instance, our mortgage company which is owned by our savings and loan holding company may not be permitted to sell mortgages to the savings and loan. Our mortgage company sells mortgages to virtually every other institution in Minnesota and buys mortgages from virtually every other institution, but is not permitted to sell mortgages to our own institution. This moves profits from TCF to our competitors.

Section 211, the net worth requirement, requires that in connection with a savings and loan holding company when it acquires a savings and loan to guarantee the net worth of that association forever. This regulation, which is being applied in a rather irregular fashion today, in effect is applied to those holding companies that can afford it the least. We believe that this regulation limits the number of people that bid on failed institutions and is a significant liability and results in an absence of capital in the savings and loan business. You can imagine lending or investing money in a savings and loan holding company that has a virtual open-ended permanent guarantee on the net worth of a subsidiary.

Section 206, the qualified thrift lender test, is currently at 60 percent, as previously mentioned. We support reducing that to 50 percent. I might point out that TCF at almost $6 billion has $1 billion of consumer loans, $1 billion of commercial and commercial real estate loans, and $4 billion of mortgage loans. In today's highly competitive environment, it is necessary to engage not just in the mortgage business through the business cycle to maintain profitability.

In summary, we support the enactment of The Thrift Enhancement Act because it addresses the needs of the profitable segment. I agree with Chairman Wall that time is everything, but time is also money. These regulations are currently costing the industry money in profits and in additional capital.

Thank you.

[The complete prepared statement of Mr. Cooper follows:]

Good morning Mr. Chairman and members of the Committee.

My name is William A. Cooper, and I am Chairman of the Board of TCF Financial Corporation, located in Minneapolis, Minnesota. I am appearing on behalf of the Association of Thrift Holding Companies.

My Company, TCF Financial Corporation, is a savings and loan holding company with headquarters in Minneapolis. We have two insured subsidiaries, TCF Banking in Minneapolis with $5 billion plus in assets and TCF Banc Savings in Texas with assets of $100 million. We also have branches in Chicago, Illinois. We are the largest thrift in Minnesota, and the third largest retail banking institution in the state.

The Association of Thrift Holding Companies represents some 40 odd companies with assets ranging from $50 million to over $20 billion. The Association was formed in November of 1985 in response to the growth in thrift holding companies and the need to provide services and representation in Washington for these types of companies.

Thrift holding companies, which have grown in number from 44 at the beginning of 1960 to more than 350 today, are companies which control a thrift subsidiary and often a variety of other kinds of businesses.

Our Association believes the holding company form represents the future in the thrift industry, and a review of industry trends will demonstrate this fact.

Our Association strongly supports the legislation you have before you today, the Thrift Charter Enhancement Act of 1988. The intent of this legislation is to eliminate needless regulatory restraints upon the operations of thrift institutions while maintaining needed safeguards to insure safety and soundness. Mr. Chairman and members of the Committee, I cannot convey to you in the time allotted the numerous occasions upon which our Association has found itself hamstrung by federal regulations which have no rational connection to concerns about safety and soundness. We need desperately to be allowed to be profitable - as does the rest of the industry. We submit that anything the Congress can do to permit us to be profitable - to enhance the value of our charter - while not adversely affecting safety and soundness - it should do. And that is the intent of the bill before you. There are currently a number of statutory and regulatory constraints that we believe can be eliminated or modified without adversely affecting safety and soundness while improving our ability to function in a more efficient fashion.

I would like to go through each of the sections of the bill to highlight the change to existing law and the benefits of the provisions.

Section 101 amends the Home Owner's Loan Act to increase the commercial loan authority of federal associations from 10 to 20% of total assets. Commercial loans, when properly underwritten, are a profitable segment of the lending business and permit a thrift to diversify its portfolio. FSLIC and FHLBB regulations have been rewritten pursuant to the Competitive Equality Banking Act of 1987 to implement the classification of assets system used by the federal banking regulators. These changes, together with the comprehensive review and oversight of commercial lending operations now provided by the district banks have dramatically improved, in our view, the commercial lending underwriting practices of thrift institutions. The percentage of assets limitation, we submit, was never any real impediment to unsafe and unsound practices. In my view, if a thrift has poor underwriting practices, it will fail even with a 10% of assets limitation.

Section 102 amends the service corporation authority of federal associations to increase the permissible investment from 2% to 4% of assets (with an additional 1% for community reinvestment). The FHLBB has had considerable experience with the service corporation authority and has exhaustively examined hundreds of possible activities, screening out those it believes to be unsuitable for thrifts. We submit that this authority has not been abused and that the activities of service corporations do not represent any significant variation in risk from the thrift's direct operating activities. The investment authority should be increased to permit additional profitability.

Section 102 also enhances FSLIC's ability to market failing thrifts by increasing service corporation investment authority by an additional 5% where the thrift or its affiliate has acquired a failed institution under Sections 408(m) or 406(f) of the National Housing Act.

Section 103 would add to the list of permissible investments of federal associations, permitting investments in Small Business Investment Companies, not to exceed the greater of one percent of assets or five percent of capital and surplus. SBIC companies are good for the country and do not present inordinate risk to the investor when properly underwritten.

Section 104 would ensure that "de novo", or other newly insured institutions would receive the same regulatory treatment as all other institutions after successfully complying for a three year period with all material requirements of the Federal Savings and Loan Insurance Corporation.

Section 201 modifies the definition of a subsidiary under the National Housing Act to exclude, for purposes of permissible activities, service corporations. Under current law and FSLIC interpretation, a service corporation of a state chartered thrift in a "multiple" holding company structure (i.e. where the holding company owns more than one thrift) is restricted in its activities to those permitted to a service corporation of a federally chartered thrift. In other words, if you have X service corporation of the ABC state chartered thrift which in turn is owned by a multiple holding company, competing with the Y service corporation of the DEF state chartered thrift which is not owned by a holding company, X cannot engage in all the same activities as Y can. Y can do whatever state law allows. X cannot; it has to follow the FHLBB rules applicable to federal associations. This amendment remedies this inconsistency.

Section 202 amends the definition of a unitary savings and loan holding company. As you know, a unitary holding company can engage in any activity it chooses. A non-unitary holding company is limited essentially to banking related activities. Under current law, if you own more than one thrift, but all or all but one were acquired as supervisory cases, you are still treated as a unitary. This amendment changes this rule to provide that a holding company is treated as a unitary if all or all but one or two of its thrifts were supervisory acquisitions. We believe this change will enhance FSLIC's ability to market failing thrifts, because it obviously permits a holding company with two "healthy" thrifts to attain unitary status by acquisition of a failing thrift.

Section 203 changes the holding company "affiliate transactions" rule. Under current law, certain transactions between the thrift and its holding company affiliates are permitted, without advance FSLIC approval, so long as they do not exceed on an aggregate annual basis, the lesser of $100,000 or .01 percent of assets. This amendment increases the threshold, so that the limit would be $100,000 or .01 percent of assets, whichever is greater. This provides a more reasonable limit for such transactions.

Section 204 would permit a thrift holding company to own up to 5% of an unaffiliated thrift. Current law prohibits any investment. The amendment would simply provide parity with commercial banks. In our view, owning up to 5% of a nonaffiliated thrift presents no undue risk to the FSLIC.

Section 205 eliminates the current provision of the National Housing Act that prohibits certain interlocks in boards of directors of insured institutions. The separate federal Depository Institutions Management Interlocks Act provides all the restriction and regulation that is required in this area, and we submit there is no demonstrated need for this additional level of regulation.

Section 206 modifies the Qualified Thrift Lender ("QTL") test. Under current law, unitary thrift holding companies must maintain QTL status for their insured institutions in order to maintain unlimited activity powers. We believe the QTL test can be improved to enhance our ability to maximize profitability while not adversely impacting safety and soundness. Currently, we must maintain 60% of assets in so called "qualified" housing related investments. We submit that this percentage can be reduced to 50% without materially changing thrifts' emphasis on housing finance. We agree that thrifts' primary emphasis has been and should continue to be housing finance, but we submit that 50% is just as reasonable and proper a number as is 60%. The Enhancement bill also provides that all assets qualifying as "liquid assets" count towards reaching the required percentage. Current law places a limit on the amount of liquid assets that can be counted - liquid assets and so called "mortgage banking" assets cannot exceed 10% of total assets. We think the maintenance of liquid assets - pursuant to the FSLIC regulations - contributes to the thrift housing finance role and should be fully counted for QTL purposes. The bill adds to the definition of liquid assets those investment grade assets that increase liquidity and protect against interest rate risk. The bill also increases the amount of "mortgage banking" assets that can be counted towards the QTL percentage. Currently, only one half of such assets (which are basically residential mortgage loans originated and sold within 90 days) can be counted. The bill increases this percentage to 100% (such assets are still subject to the overall 10% of assets limitation; i.e. they cannot be counted to the extent that they exceed 10% of total assets).

Section 207 eliminates the crossmarketing restrictions applicable to diversified thrift holding companies (a "diversified" company is basically one that earns a majority of its income from non-thrift related activities). As you know, the Competitive Equality Banking Act of 1987 ("CEBA") contained these current provisions which provide that a diversified company cannot crossmarket between affiliates, except as to crossmarketing in place on March 5, 1987. We believe these restrictions are anti-competitive and restrict the ability to be profitable. We believe in a free market economy, consistent with reasonable consumer protection. No one has ever successfully demonstrated why it hurts the consumer to shop for financial products in one location: we think it is wrong to prohibit crossmarketing: a prohibition drives prices up at the expense of consumers and to the benefit of protected industries.

Section 208 changes the "affiliate transactions" rules set forth in CEBA (affiliate transactions refers to transactions (e.g. purchases, sales, loans) between a thrift and its holding company and affiliates). Under the CEBA affiliate transactions

rules, a bank holding company and its affiliates that limit their activities to bank services related activities (Section 4c8 of the Bank Holding Company Act ("BHCA")) are subject to the BHCA affiliate transactions, and not the FSLIC holding company affiliate rules. The Enhancement bill would make the CEBA rules (and hence the BHCA affiliate rules) applicable to any thrift holding company that had acquired a failed thrift. This change will help FSLIC marketing of failed thrifts and also make the bank regulators' affiliate rules more generally applicable to thrift holding companies.

Section 209 amends the CEBA provisions which relate to mutual holding companies. My company is not a mutual, and I would respectfully defer to Mr. Patrick Forte of our Association with respect to questions on this issue.

Section 210 of the bill eliminates a current requirement of the National Housing Act which requires a thrift holding company to file an application with the Federal Savings and Loan Insurance Corporation virtually every time it or a subsidiary wishes to incur debt. If my holding company wishes to borrow money, or one of our holding company subsidiaries wishes to borrow money, generally they cannot do so without filing what's called in the regulatory parlance, an H-(g), and the Federal Home Loan Bank in Des Moines has the ability to reject that application. We have to wait 60 days after we file the application before we can incur the debt. Mr. Chairman and members of the Committee, it takes time and money and people and lawyers to file these applications. One would think there is some safety and soundness concern that is behind the existing requirement. But we can't find anyone at the Bank Board or elsewhere who takes the position that this requirement is on the books for safety and soundness reasons. To the contrary, no one knows why this requirement continues to exist, and there is no comparable provision on the commercial bank side. And so this bill would eliminate the requirement that our holding company file an application every time it wants to borrow money.

Section 211 of the bill would modify current Bank Board practice in the area of net worth maintenance agreements. The Bank Board currently requires holding companies to execute open ended net worth maintenance agreements under which the holding company guarantees the net worth of the thrift forever. Now at first blush, you might say that's a good idea. But it really proves to be a detriment to the acquisition of new capital for the business and also proves to be discriminatory in practice in favor of large conglomerates. If you hope to attract participants to the thrift business, you cannot insist on a net worth guarantee into infinity. To do so scares buyers away. And it is not an answer to say that the FSLIC can always negotiate the net worth guarantee down for those buyers who express reluctance, for two reasons. First, many buyers won't

complain, they just won't show up at the bidding conference. Second, why should the big conglomerates with all the muscle get a reduction in the guarantee while the rest of us don't. Currently, FSLIC policy is to require a guarantee into infinity, but FSLIC makes exceptions ad hoc and in my opinion in a very discriminatory fashion. This bill would retain the ability of FSLIC to require a guarantee, but it would limit its duration to three years unless FSLIC determines there is a regulatory capital problem, in which case it could extend it. I should also point out that to my knowledge the FDIC has <u>not</u> generally required such a guarantee from bank holding companies.

Section 212 of the bill modifies the FSLIC conflict of interest or affiliate transactions rules. The bill would replace the existing FSLIC rules with the rules of the Federal Reserve Board, the FDIC and the Comptroller of the Currency. The current FSLIC rules are frankly no longer suited to the complex nature of the business. They are confusing and in many cases in the past have led to absurd results. Let me give you one example. If our holding company had a mortgage banking subsidiary that made mortgage loans, it could not (at least up to last October) sell them to an insured subsidiary even with FSLIC approval. This is because although the holding company regulations permit such a sale with prior approval, the general FSLIC conflict rules prohibit such a loan sale. This is, frankly, absurd. Our mortgage banking subsidiary sells loans to every institution in the state, and our thrift buys loans from every institution in the state, but our thrift can't deal with our own mortgage banking subsidiary, even on arms length terms. This removes profitability from both companies and forces us to essentially give away some of our profit to our competitors. And so this bill would make the banking conflict regulations - which fully insure safety and soundness and prevent self-dealing - applicable to thrifts.

Section 301 amends the Depository Institutions Management Interlocks Act. Basically, this section adds failing thrifts to the exceptions to the prohibition against interlocking directorships. This change will enhance the marketability of failing thrifts. The amendment would also provide for a regulatory override of the generally statutory prohibition against interlocks. The current outright prohibition does adversely impact the market in some cases, and providing the regulators (who are in a good position to measure the need for a prohibition in each individual circumstance) with the ability to override the prohibition in select cases makes sense, in our view.

In summary, we support the Enhancement Act because it addresses the needs of the profitable segment of the thrift business, a segment that's often forgotten. The thrift industry needs all the capital it can get. Our view is that the way to get that additional capital into the business - and to avoid a flight to the FDIC - is to permit thrifts that are healthy and profitable to operate like other businesses in this country, consistent with safety and soundness. This bill enhances the thrift holding company charter without affecting safety and soundness. It is a very good step in the right direction.

The CHAIRMAN. Mr. Pitt, Federal Home Loan Bank Board officials say the thrift charter is already the best in town. In the main, thrifts and their holding companies have more powers, less regulation, and greater tax advantages than banks have. The main problem with an S&L charter is FSLIC insurance, which is both costly and unconvincing.

Would it not make more sense to clean up the mess in the thrift industry before granting thrifts greater license?

Mr. PITT. Mr. Chairman, certainly there are problems within the industry. One thing that I think the recent events have pointed out, particularly in the Southwest, something we've been saying for a good while, and that is that the problems were not just problems of the thrift industry but they were problems of a regional economy. And I think the events of the last 3 or 4 weeks certainly point that out.

On the other hand, there are some differences, as has been pointed out, between State laws and Federal laws and Federal associations are at some disadvantage as they relate to individual States and we believe that some of these inequities should be cleaned up.

As to the specific timing, we believe that there is an appropriate time to consider this legislation and it should be considered. We believe that probably early on in the next Congress would be an appropriate time.

The CHAIRMAN. Mr. Nunn, the bill would weaken the QTL test and increase lending authority to thrifts and facilitate transaction between thrift institutions and their affiliates. If the bill were enacted, what would distinguish a thrift from a nonbank bank?

Mr. NUNN. Very little. I think it pretty well breaches that loophole that you tried to close—that you did close last year. So I think it opens it back up.

The CHAIRMAN. Mr. Koch, in your written testimony you point out that capital deficiencies that currently exist in the S&L industry. You argue that outside capital must be attracted to this industry. The Karnes bill, you believe, will greatly assist the industry in attracting these funds.

GAMBLING AT THE PUBLIC'S EXPENSE

Now the uncharitable might argue that what the bill does is to offer both outsiders and insiders a license to gamble through risky commercial loans and direct investment powers at the public's expense.

How do you respond to that charge?

Mr. KOCH. I think that the provisions of the Karnes bill, which only allow those expanded powers for well-capitalized thrifts address that concern. As I mentioned in my comments, it is critical that we protect the healthy segment of the industry. To give another example, related to the QTL test, because we have an industry that is basically insolvent. There are a lot of "sickies" out there in the marketplace doing really dumb things, like making fixed-rate loans way below the market in a desperate effort to keep their doors open. If you permit this and don't allow healthy institutions who are competing across the street to have some diversity in their products, all you're going to do is drag down the entire industry and make the situation much, much worse.

I think that if you put the proper safeguards in place and only let the institutions that have capital play the game, you are going to go a long way toward meeting the problem that you raise.

The CHAIRMAN. Others might argue that what you're doing here isn't helping the people who need the help; it's helping the people who don't need the help. I can see your point and it's not a bad one. I think that's probably the strongest part of the bill. Nevertheless, I think that one major counterargument is it wouldn't do any good for many of the S&L's in Texas or Oklahoma, for example.

Mr. KOCH. This bill clearly, as I envision it, would not do much good for the S&L's in Texas or Oklahoma, but it might entice individuals that have capital to buy those institutions or to require less FSLIC assistance when they acquire them. So the net effect would be that it would help clean up the situation down in the Southwest and it might well save FSLIC quite a bit of money in that part of the country by enticing other institutions or outsiders to come in and invest their money in that area.

The CHAIRMAN. Mr. Cooper, in a letter to the chairman, GAO says that the thrifts in general have not used the expanded commercial lending powers conferred by the Garn-St Germain Depository Institutions Act of 1982. Data accompanying the letter show that at the end of June 1987, thrifts had only 1.9 percent of their assets in commercial loans, much less than the current Federal maximum of 10 percent.

Who, in your estimation, would use the additional commercial loan powers of the Thrift Charter Enhancement Act?

Mr. COOPER. There's a very large diversity in thrifts today in terms of the kinds of businesses that they engage in. I think some institutions would make use of the expanded powers, particularly those that were connected with commercial banking industry. Some institutions would not, but the key to that provision is that it enhances the value in terms of the potential of things that you can do with a thrift charter.

The CHAIRMAN. Senator Karnes.

Senator KARNES. Thank you, Mr. Chairman.

I would like to extend my sincerest appreciation to each of the panelists for coming today and presenting their testimony which I believe was in each instance, very thoughtful and very much to the point.

I would also like to thank Mr. Nunn for his nice comments. I have been working with the Independent Bankers very closely on a number of fronts, and I'm pleased, as was indicated, that we've had a great deal of success.

Mr. Nunn, one of the things, that I hear more frequently than anything else as I travel around the State of Nebraska dealing with many of the smaller bankers in the small communities of Nebraska is the fact that they find it very difficult to compete with several of the marginally solvent thrifts in the State that are putting loans on the books or generating deposits at rates that are inconsistent with their cost of funds. Nebraska is not a place where we have a lot of major loans. This is very much small business type practice and many in the banks in our State, our 456 banks, are independent banks or smaller banks, but they continue to find great frustration in dealing with the smaller thrifts in our State.

And these are thrifts that are not part of the Southwest plan or any other plan. These are thrifts that are going to be around for quite a while and are operating, in many instances, in a fiscally irresponsible fashion, but that's the only option they have because the FSLIC assistance will not get to this level of thrifts for many, many years.

I'm afraid that this slowly spreading cancer in some of the smaller States of Kansas and Nebraska that is going to take down not only the thrifts, but some of the smaller banks that are unable to keep deposits on their books or attract loans. The only way these thrifts are able to keep their doors open is to compete using pricing tactics they know the FSLIC will not be looking at and challenging because the agency does not have the personnel to deal with these smaller problem institutions.

I just want everyone to appreciate my concern that some of these smaller banks that have served their communities so well over the years are now being impacted by some of these thrifts. I think if we can attract more capital for the acquisition of troubled thrifts it will allow the FSLIC more room to deal with some of these other institutions that aren't on the front pages of the Thrift News or the Wall Street Journal, but that are out there affecting people's lives. And Mr. Nunn, I know you hear about this from your bankers, too. But that is one of the reasons why I've introduced this bill and why I believe that time is of the essence. We need to deal with this bill now.

Also, I am trying to encourage a meaningful proposal short of additional FSLIC borrowing authorization, or a Treasury bailout, or, something that I hear also from the bankers—a merger of the FDIC and the FSLIC, which I think is inappropriate at this time. So I can't underscore the importance of attracting additional capital to the thirft industry.

That's more of a statement than a question, but I hear that a lot from some of the smaller lending institutions and commercial banks that you're never going to see in the papers.

Mr. NUNN. Mr. Chairman, may I make a statement along with Senator Karnes?

The CHAIRMAN. Yes, indeed.

Mr. NUNN. We at IBAA are certainly aware of the problems of FSLIC and the whole financial crisis that we have. We are not trying to throw sand in S&L's faces. We know that they have a place in the home lending field. We have started a task force in our organization to study this problem because if it's S&L's problem, it's ours too.

We haven't progressed to any great extent, but I think we must be aware that, as Chairman Wall stated—Senator Karnes, I understand your concern for the small bank, but the analogy you might come up with for that is, well, we pass legislation that might cut one leg off but you'll sure have a permanent limp.

And when you try to correct that funding problem that those S&L's have in Nebraska, it's going to have to be done with regulations that you have now. It's going to take some creativity that Chairman Wall is evidently trying to undertake.

All financial institutions in the Southwest are not in problems. We live in a community of 7,500 people. We have three commercial

banks and one savings and loan. The savings and loan is a traditional savings and loan, has capital the same way that I count capital of 8.25 percent. They make home loans. They have not undertaken any of the new powers as granted in 1982 and they make money. So it's the people that have taken the powers and abused them that have caused the problem. Chairman Wall said 10 percent.

We need to focus on that 10 percent and our task force will make every effort to find out what those 10 percent are doing to let them comply with the 90 percent. So this bill would actually—I appreciate your intent and everyone should applaud it because it needs to be aired—but what this bill would do would change the whole financial structure of the United States.

We think the financial structure of the United States has been served well with the diverse institutions that are scattered. We think that the dual banking system is something that has served our consumers well. We hate to see any type of legislation that would appeal to a certain greed factor in any one group.

Mr. PITT. Mr. Chairman, may I respond to Mr. Nunn?

The CHAIRMAN. Mr. Pitt.

Mr. PITT. I just want to be sure that one point is clarified. We certainly have had our problems within our industry with the area of greed and misuse of powers, but I would be remiss if I didn't try to clarify that that has been a very, very small aspect of the problems that have been created and that are faced by the thrift industry and by our deposit insurance fund.

I reiterate the point I made earlier that a lot of the problems that we experience are problems that have been created by regional economic problems that were not of our doing. We do have 10 percent of our industry, as was pointed out by Chairman Wall, that are unprofitable; but if you look at that 10 percent I think you'll find a very, very small percentage that is the result of abused powers. Thank you.

Mr. KOCH. I also would like to respond to Mr. Nunn's comment. My institution has 7.5 percent GAAP capital and quite frankly we could convert to an FDIC insurance tomorrow afternoon if we were so of a mind to do it.

Mr. Nunn is apparently very fortunate that he has well-run profitable, well-capitalized institutions in his marketplace. I come from Cleveland, OH and we've been cursed with insolvent S&L's as very large direct competitors of ours since 1980. It's very, very difficult to compete with people that are not playing with their own capital but are playing with FSLIC's capital. They do really dumb things. If I were to allow my institution to compete directly with them and make below market rate, fixed-rate 30-year mortgages, I'm afraid I also would find myself on the FSLIC doorstep in not too long a period of time.

It's been 8 solid years since we've had all healthy institutions in my city and I see no end to it. If the Congress could tell me that in the next 6 to 12 months that all those institutions were going to go away and I were going to be playing on a level playing field with them, I don't think we would need this bill. But, unfortunately, I don't think that's the case. At least it hasn't been the history of what we've seen.

So I think that we need to do something to protect the healthy segment of the industry. And if it means some somewhat expanded powers to invest in products from time to time that are available to us when the housing mortgage market is not available to us, then I think it's critically necessary. Thank you.

The CHAIRMAN. Mr. Cooper.

Mr. COOPER. I'd like to comment briefly on the concept of the commercial loan limitations and the qualified thrift lender test.

In the banking business or the savings and loan business, there is no margin profit without risk, either credit risk or rate risk. And one of the essences of managing risk is diversity. Any financial institution that invests all of its assets in one kind of thing—be it foreign loans, junk bonds, commercial loans or even mortgages—an institution that has just a portfolio of mortgages and only originates mortgages runs the risk of a lack of diversity in its business. And when the home business is a bad business, then that institution is in trouble.

You'll note that part of the problem that occurred in this industry occurred in the late 1970's and early 1980's before there was a lot of deregulation and it occurred because of the rate risks associated with those institutions having only mortgages in their portfolio.

I would like to state that I feel that the diversity of that over time, run by good managers, without crooks and so forth, would strengthen the industry while maintaining still——

REASON FOR SAVINGS AND LOAN INDUSTRY

The CHAIRMAN. Mr. Cooper, if you're going to do that, why not just abolish the savings and loan industry entirely? We created it expressly and exclusively for the purpose of helping people buy homes and it's worked for many, many years very well.

Now what you're saying is that you've got to diversify into a lot of other things, commercial loans, and that's fine, but that's what the banks do. If you do that, why shouldn't you have bank-type regulation and capital standards the same as banks?

Mr. COOPER. I agree that that's the reason the industry was formed and I agree that it should be still predominantly in that business. There are 80 originators of mortgages in the Twin Cities area, most of them not savings and loans. They are owned by General Motors or Prudential or Merrill Lynch, independently owned, whatever. The mortgage business is an extremely competitive business. Nobody originates more than 3 percent of the mortgages in the Twin Cities area.

I do agree that the preponderance of business in the savings and loan business under the revised regulations should be in the mortgage business and that's a good thing for the country and a good thing for the industry.

The CHAIRMAN. Well, that's my problem. I think the world of Senator Karnes. He's a very fine Senator and he knows probably more about this industry than anybody on the committee. He worked in it himself. But if this bill passes, it seems to me it's a long step toward taking the savings and loan industry out of home lending. It's moving along in that direction and, as I say, if you're

going to do that, you ought to have bank-type regulations and capital standards the same as banks. Banks can make mortgage loans, too, and do.

Senator KARNES. Mr. Chairman, I share with you my great concern for making sure that the focus of the thrift industry is on its greatest asset which is expertise in the area of lending for housing, and I think thrifts have done that very well.

I am concerned that we are seeing the FSLIC just handicapped at this point by a lack of resources. I would like to underscore that I share with you an interest in making sure that the thrift industry does keep its focus on housing, and I hope that this legislation which I'm proposing is a reasonable and measured approach to encouraging that in the future. I appreciate your comments.

Last, I'd would like to mention again, Mr. Nunn, that, as a compliment to your members, I believe that all they want to do is compete fairly. They have no problems with competing against any thrifts in the country as long as they see thrifts using their own capital, rather than, as Mr. Koch stated, somebody else's capital.

Mr. Chairman, I have to run. I just want to tell you I appreciate you holding these hearings and responding to my request during the Proxmire bill debate that we have these hearings as soon as possible and I really appreciate your expeditious scheduling of them very much.

The CHAIRMAN. Thank you very much, Senator Karnes.

Thank you, gentlemen, very much for excellent testimony.

The committee will stand in recess.

[Whereupon, at 12:10 p.m., the hearing was adjourned.]

[Response to written questions from witnesses and additional material supplied for the record follows:]

USL
UNITED STATES LEAGUE of SAVINGS INSTITUTIONS 111 EAST WACKER DR. / CHICAGO, ILLINOIS 60601 / TEL. (312) 644-3100

THEO H. PITT JR.
Chairman
325 Nash Street
Rocky Mount, North Carolina 27804

May 20, 1988

The Honorable William Proxmire
Chairman
Committee on Banking,
Housing and Urban Affairs
Room 534
Dirksen Senate Office Building
Washington, D.C. 20510-6075

Dear Chairman Proxmire:

Thank you for this opportunity to expand for the record on my testimony of April 27 regarding the "Thrift Charter Enhancement Act of 1988" through additional questions posed by Senator John Chafee. Following are my responses to Senator Chafee's questions:

Q.1 What evidence is there that non-failing thrifts are not attracting equity capital? What is the rate of return on equity for non-failing thrifts?

A.1 The October 19, 1987 stock market crash had a chilling effect, but it was one that extended to virtually all new issues as potential investors exercised a new wariness not previously in evidence. However, records maintained by the Federal Home Loan Bank Board do not sustain the conclusion that healthy thrifts are not attracting equity capital.

Conversions from mutual to stock ownership are a relatively new development for savings institutions, having begun in 1975. During the period 1975-82, only 133 conversions involving $600 million in stockholder equity were effected. In 1983, however, the conversion movement took off. According to Bank Board records there were 83 mutual-to-stock conversions in 1983, representing stockholder equity of $2.75 billion. In 1984, the number was 96 institutions representing $715 million in equity; 1985, 78 institutions and $1.4 billion; 1986, 86 institutions and $2.5 billion; and 1987, 130 institutions and $1.96 billion. As of May 19 of this year, the Bank Board had recorded 33 conversions representing $250 million in stockholder equity. As you can see, some $10 billion in

equity capital has come into the savings institution business in the past five years alone.

Data compiled by the U.S. League's Research Department shows the return on equity of non-failing thrifts (defined as institutions reporting positive net worth using generally accepted accounting principles) was 7.14% in calendar year 1987.

Q.2 Who has been inhibited from acquiring thrifts? Why?

A.2 Generally, bank holding companies are prohibited by Federal Reserve regulations from purchasing healthy savings institutions. However, the Garn-St Germain Act of 1982 established a procedure whereby bank holding companies may purchase troubled savings institutions under certain conditions.

Similarly, it apparently was the de facto policy of the Federal Home Loan Bank Board under former Chairman Edwin Gray to prohibit firms engaged in securities activities from owning savings institutions. This policy was breached in March 1988 when the new Bank Board, under Chairman M. Danny Wall, permitted Statesman Group, Inc., a Des Moines, Iowa, diversified company engaging in insurance and securities activities, to purchase four troubled savings institutions in Florida and Iowa with assistance from the FSLIC.

Q.3 If this bill were passed as written, do you feel your member institutions would agree to continue with FSLIC insurance, including special assessments if necessary? For how long?

A.3 While the "Thrift Charter Enhancement Act of 1988" contains many positive provisions that would be of benefit to savings institutions, we do not believe that they, in aggregate, provide a sufficient counterbalance to the 1/8th of 1% special assessment which has been levied by the FSLIC for the past three years to deter conversions to FDIC insurance.

Q.4 Is it your understanding that were the FSLIC to run out of cash, that the next backstop source of funds is the insured thrifts themselves through a special 1%-of-deposits assessment?

A.4 Section 404(i) of the National Housing Act provides the FSLIC with authority to require institutions

it insures to place an amount equal to up to 1% of their deposits on deposit with the FSLIC for an indefinite time period. Under law these deposits must yield an annual percentage rate of return equal to that earned by the FSLIC on its Treasury obligations; interest is to be credited to the institution's FSLIC account.

This authority has never been invoked and we have no reason to believe that the FSLIC is now contemplating such an action. We have reason to believe that the Financial Accounting Standards Board would not permit our institutions to carry this item on their books as an asset. Thus, the effect of such an action would be a substantial reduction in net worth which likely would push marginal institutions into the problem category. This could be avoided, of course, through Congressional action to guarantee federal repayment of the forced deposit and to ensure that the deposit could be treated as an asset for securities disclosure purposes. In addition, from the FSLIC's perspective, the $9 billion or so which the fund would receive would add an equivalent amount to its liabilities so that little would be accomplished in terms of bolstering its balance sheet.

Again, thank you for this opportunity to expand on my testimony. Should you have further questions, please feel free to contact me or Phil Gasteyer, the U.S. League's Executive Vice President and Director of Washington Operations.

Sincerely,

Theo Pitt, Jr.
Chairman

cc: The Honorable John Chafee

The National Council's Response to Questions
for the Record on Testimony of Charles John Koch, Chairman,
National Council of Savings Institutions
on Hearings on April 27, 1988, before the
Senate Committee on Banking, Housing and Urban Affairs
on S. 2073, the "Thrift Charter Enhancement Act of 1988"

Question for the Record from Committee Chairman William Proxmire

Q.1. You testified that S. 2073 would expand the direct investment and commercial lending powers only of "well-capitalized thrifts".

(a) Do you contend that the expanded powers granted by sections 102, 103, and 201 would be available only to well-capitalized S&Ls? If so, please explain how that would be the case.

The Council would not oppose an amendment to sections 102 and 103 of the bill that would condition the expansion of investment powers of Federally-chartered savings and loan associations in service corporations and small business investment companies on the institutions' conforming to capital standards set by the Federal Home Loan Bank Board. As to the definition of "capital standard", please see the response in subsection (b) immediately below.

(b) Do you regard an S&L as "well-capitalized" simply because it meets those requirements in three out of four quarters?

The Council generally supported the Federal Home Loan Bank Board's regulation implementing provisions in the Competitive Equality Banking Act of 1987 that require Federally-insured S&Ls to phase in capital standards in accordance with generally accepted accounting principles by the end of 1983. For purposes of sections 101, 102 and 103 of S. 2073, however, we would support an amendment that would condition the exercise of these powers on institutions meeting a net worth standard measured in accordance with GAAP.

The National Council's Response to Questions
for the Record on Testimony of Charles John Koch, Chairman,
National Council of Savings Institutions
on Hearings on April 27, 1988, before the
Senate Committee on Banking, Housing and Urban Affairs
on S. 2073, the "Thrift Charter Enhancement Act of 1988"

Questions by Senator John H. Chafee

Q.1. What evidence is there that non-failing thrifts are not attracting equity capital? What is the rate of return on equity for non-failing thrifts?

We are currently assembling data on the relative prices of new stock issues of thrift institutions compared to other businesses and will be glad to provide this information to the Committee when it is available.

Our testimony, however, related to the attraction of capital from outside the savings and loan industry, e.g., the manufacturing sector, by eliminating many of the disincentives that currently exist for such acquisition in the Savings and Loan Holding Company Act.

Our data show that the ratio of adjusted net income to total GAAP capital for thrifts with GAAP net worth greater than zero percent is 6.954 percent. For institutions with GAAP net worth of over three percent, this ratio is 9.86 percent.

Q.2. Who has been inhibited from acquiring thrifts? Why?

Many of the proposed amendments to the S&L Holding Company Act delete provisions which have been frustrating to S&L holding company management themselves for many years. Amendments to that Act are based on the assumption that if such provisions were frustrating internally, they would of necessity be disincentives for potential buyers who are considering buying an S&L.

Q.3. If this bill were passed as written, do you feel your member institutions would agree to continue with FSLIC insurance, including special assessments if necessary? For how long?

The effect of this bill on individual institutions and their relatiohsip with FSLIC is not possible to determine. The central thrust of this bill is to attract purchasers of S&L associations, which, after the purchase, would not be able to convert the S&L to FDIC insurance thereby creating a bank holding company, because such purchasers are expected to be companies that are engaged in activities that are not permissible for bank holding companies. The advantages of S&L ownership for these new purchasers would have to outweigh the disadvantages of the special assessment. This is an additional reason to provide a reduction in the special assessment for well-capitalized institutions and to clear out the existing disincentives in the Savings and Loan Holding Company Act.

Q.4. Is it your understanding that were the FSLIC to run out of cash, that the next backstop source of funds is the insured thrifts themselves through a special 1%-of-deposits assessment?

We believe that an assessment by the FSLIC of 1%-of-deposits of FSLIC-insured institutions would be self-defeating because it would weaken the capital structure of healthy thrifts and exacerbate the problems of failing thrifts. In January, 1988, our membership approved a contingency plan for the merger of the two insurance funds which proposed the following funding principles for the FSLIC:

1. The FSLIC could raise $25 billion in the next two years as follows:

   $10 billion - in premiums and recapitalization funds

   $5 billion - exit fees

   $2.5 billion - Federal Home Loan Bank contributions from surplus and earnings over the next 2-3 years

   $10 billion - contributed from FDIC

2. Additional costs, if any, to be borne by the remaining surplus of the Federal Home Loan Bank, the Treasury, or a combination of the two.

3. Increase of FDIC's borrowing from Treasury from $3 billion to $10 billion.

This payment plan would enable the FDIC to continue with a substantial insurance fund with the potential to borrow a large amount from Treasury, should the need arise. The plan would only require Treasury outlays if the cost of resolving FSLIC's problem is very substantial, and then only after large contributions from other sources. It would set a limit on the additional burden placed on those institutions currently insured by FSLIC.

Questions for the Record from Senator John Chafee
From April 27, 1988 Hearing

For Mr. William A. Cooper

Q.1. What evidence is there that non-failing thrifts are not attracting equity capital? What is the rate of return on equity for non-failing thrifts?

Answer: I believe that thrift stocks are undervalued and in essence discounted because investors are understandably concerned with the fate of the Federal Savings and Loan Insurance Corporation. This discount is applied to healthy thrifts as well as failing thrifts. Since our stocks are undervalued, we obviously obtain less capital in both initial and secondary stock offerings than we should, and there have been few such secondary offerings. We believe that one way to counter this discounting fact or is to enhance the value of a thrift charter. As the value of a thrift charter is enhanced (through such measures as The Thrift Charter Enhancement Act of 1988), there will undoubtedly be a renewed interest in thrifts and consequently thrift stocks. This increased interest will have the effect of improving stock values and our ability to attract equity capital to the industry. Obviously, to the extent that additional capital is channeled into the thrift industry from private sources, less would be required from public sources.

I have attached a copy of a publication reflecting return on equity for publicly held thrifts, which I think addresses the second part of this question.

Q.2. Who has been inhibited from acquiring thrifts? Why?

Answer: Banks, securities firms, insurance companies, and "diversified activity" companies. Banks have been precluded from acquiring all but unhealthy thrifts as a result of an adverse regulatory and political climate. Both bank regulators and thrift regulators historically have opposed bank ownership of thrifts. Consequently, the Federal Reserve Board, with full cooperation from the Federal Home Loan Bank Board, authorizes banks and bank holding companies to own only failing thrifts, and not healthy thrifts, under an interpretation of the Bank Holding Company Act provisions. Securities firms have historically been prohibited from ownership of healthy thrifts by the Federal Home Loan Bank Board, through administrative fiat. Although there is no prohibition in the Savings and Loan Holding Company Amendments to the National Housing Act that would preclude security firm ownership of a thrift, Chairman Gray several years ago adopted a policy of precluding such

ownership. In fact, all savings and loan holding companies have been required to execute agreements to the effect that they will not engage in most securities activities. When Chairman Wall assumed his current position, this edict was reportedly rescinded. Insurance companies have been precluded from acquiring thrifts due to the procedural morass attendant to accomplishing an acquisition, and due to a prohibition against holding thrift stocks in portfolio. In this regard, regulators either intentionally or unintentionally have delayed applications to the point that large insurance companies have been dissuaded from applying for ownership. "Diversified companies", or those that engage in non-financial activities, have been inhibited from acquiring thrifts by virtue of the activity restrictions imposed upon "multiple" savings and loan holding companies. A multiple savings and loan holding company is one that owns more than one thrift. Multiple savings and loan holding companies cannot engage in non-financial activities, whereas a "unitary" savings and loan holding company that owns only one thrift is not precluded from any business activity. Consequently, since most diversified companies would seek to own more than one thrift in order to operate in more than one state, and since ownership of only one thrift does not really comport with the business plan for a diversified company, most diversified companies have not made any significant entry into the thrift industry. Diversifieds (and others) have also been dissuaded by the FSLIC's requirement that any owner of a thrift must guarantee its net worth in perpetuity. This net worth guarantee requirement, not used by commercial bank regulators, has also been an impediment to thrift ownership.

Q.3. If this bill were passed as written, do you feel your member institutions would agree to continue with FSLIC insurance, including special assessments if necessary? For how long?

Answer: I do not see this bill as a solution, in and of itself, to the FSLIC insurance problem. Obviously, I strongly believe that enhancing the thrift charter will attract additional capital into the thrift industry, and that the attraction of that new capital will bode well for the improvement in the insurance fund. However, the FSLIC insurance problem runs so deep, that charter enhancement in and of itself is not a solution to the problem. As you know, our association supports a merger of the FSLIC and FDIC funds as a solution to the problem.

Q.4. Is it your understanding that were the FSLIC to run out of cash, that the next backstop source of funds is the insured thrifts themselves through a special 1%-of-deposits assessment?

Answer: Although I understand there are some legal issues present, it is my understanding that the FSLIC takes the position that it has the authority to make an additional

1%-of-deposit assessment. Our attorneys frankly think that there are considerable legal obstacles to such an assessment. The legal obstacles, however, are rendered moot by the fact that a 1%-of-deposit special assessment is totally unrealistic economically. Thrifts simply cannot afford to pay it, and such an assessment would bankrupt the system.

GJP1074/9

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

Warren Lasko
Executive Vice President
(202) 861-6501

March 24, 1988

The Honorable David K. Karnes
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20515

Dear Senator Karnes:

Thank you for your March 4 letter requesting our comments on S 2073, the "Thrift Charter Enhancement Act of 1988," introduced by you on February 18, 1988. In response to problems plaguing the thrift industry and its insurance fund, your bill is intended to make thrift charters more attractive to both current and potential private investors by creating new investment powers for thrifts, and by removing certain restrictions under current law on thrift operations.

MBA supports a strong and vibrant thrift industry. To this end, we believe statutory and regulatory enhancements to thrift charters (consistent with principles of safety and soundness) will help attract much needed investment capital to the industry. Several provisions in your legislation would promote investment in thrifts and reinforce the commitments of those already involved in the industry.

Section 206 of S 2073 is of particular interest to the mortgage banking industry, and MBA strongly supports this provision. This provision would amend the qualified thrift lender (QTL) test found in Section 104(c) of the "Competitive Equality Banking Act of 1987" (CEBA) (P.L. 100-86), signed into law on August 10, 1987. CEBA requires insured thrift institutions to hold at least 60 percent of tangible assets in residential, mortgage-related assets. In meeting this requirement, a thrift may count 50 percent of the dollar amount of residential mortgages loans it or its subsidiary originates and sells within 90 days after origination, up to 10 percent of total tangible assets. Meeting the QTL test is important because unless a thrift subsidiary meets the test, a diversified savings and loan holding company (i.e. one that engages in both thrift and non-thrift activities) is restricted to the limited activities allowed for multiple savings and loan holding companies.

Section 206 of S 2073 would modify this test by permitting 100 percent, as opposed to 50 percent, of mortgage origination/sales activities to count as qualified investments within the 10 percent basket. It also would phase in, over a three year period, a reduction from 60 percent to 50 percent in the required percentage that residential mortgage-related assets must represent of total assets.

MBA in general opposes the QTL test; however, since the test is required, we believe the full amount of mortgages originated for sale into the secondary market should be counted in meeting the test. Because Section 206 of S 2073 would significantly broaden the eligibility of loans originated for sale in meeting the test, while simultaneously reducing the percentage of mortgage-related assets required to meet the test, we strongly support this provision.

I want you to know that we applaud your initiative to find practical, effective ways to preserve thrifts as a source of capital for housing. You may find interesting the enclosed article on this theme that we recently published in the weekly newspaper, Real Estate Finance Today.

Please contact Burton C. Wood, MBA's Legislative Counsel at 861-6507, should you have any questions or need additional information.

Sincerely,

Warren Lasko

Warren Lasko
REFT Column
March 14, 1988

DON'T WRITE OFF THE THRIFTS

New proposals are emerging for further augmenting the resources of the FSLIC. Last year's $10.8 billion support program is inadequate, some people believe, in view of continuing thrift insolvencies, particularly in the Southwest.

A recent Washington Post editorial, reprinted on this page, concludes that "if closing down the insolvent S&Ls requires public money, that should be a signal that the S&L industry is no longer viable." The Post goes on to suggest that any further federal assistance, or a merger of the FSLIC with the FDIC, be accompanied by requirements that healthy S&Ls convert into banks and that the existing S&L system be abolished as "too unstable and too expensive to survive in the present economy."

The Post at best is premature and at worst is dead wrong, at least if you believe in housing as a national priority. The problems in the thrift industry are lodged among a minority of institutions, perhaps less than one-fourth of the total. The substantial majority remain healthy. They should not have the problems of the minority laid at their feet. And this integral part of the nation's housing finance system should not be sacrificed on a pyre not of its own making.

Thrift industry problems have two roots fed by forces beyond their control. First is a problem of regulatory failure. During the rush to deregulate in the early 1980s, thrift deposit rates

were lifted far faster than S&Ls could adjust their asset composition. Furthermore, asset powers were loosened while the Federal Home Loan Bank Board's oversight capacity was left unequal to its responsibilities.

Second is the problem of regional economic distress, particularly in energy and agriculturally-dependent sections of the country. Thrifts are certainly not alone in suffering economic devastation where unforeseen reversals in long-term economic trends wiped out traditionally sound enterprises.

There are enormously important public policy reasons for preserving a healthy thrift industry and for building closer linkages between thrifts, mortgage bankers, and others in the mortgage business.

John Kenneth Galbraith recently said, "The inadequate provision of housing . . . can be considered the single greatest default of modern capitalism."[1] In this light, the Post's suggestion that the traditional S&L system could be abolished is wrong on at least two grounds. First, it overlooks the particular roots of current problems and their reversibility. Second, we should conserve, not unravel, what is still good in the fabric of the mortgage finance network, a fabric that at one time promotes savings and generates funds for housing.

The historical and still-sound basis for the thrift industry is the coupling of household savings with housing investments. For large numbers of American families, the local thrift

---

[1] Quoted from "Economics in Perspective," Houghton Mifflin Company, Boston, 1987.

institution is still a place to safely store one's life savings. So, too, it is a place for many in America to shop for a mortgage. At a time when housing is increasingly expensive, when home ownership is out of reach for increasing numbers of young families, and when major institutions are pulling out of mortgage finance, this is a time to look for ways to preserve the historic fabric of housing finance, not to dissolve it. But the housing finance institutions should be preserved in ways that make maximum advantage of efficient secondary market opportunities and create a level field for competition among a number of different groups of lenders, not just thrift institutions.

Mortgage bankers and thrifts account for about two-thirds of the $300 to $400 billion in residential loans made each year. It is in the interests of both industries to help assure the stability and preservation of the other. Indeed there are many linkages. One-third of the largest mortgage companies have a direct corporate affiliation with a thrift institution. Thrifts provide warehouse financing and an investment outlet for mortgage companies. In turn, mortgage companies are efficient, low-cost interstate originators, marketers, and servicers of mortgage products.

Those in the mortgage finance arena should work together to build the most efficient mortgage finance system possible using the full array of building blocks available. Thrifts are an effective accumulator of capital, and they deliver that capital to housing. Thrifts are the single largest group of investors in mortgage-backed securities produced by mortgage companies.

84-991 0 - 88 - 5

Mortgage companies in turn, through their history and their structure, are uniquely equipped to make, market, and service mortgages at the lowest possible cost and to use the facilities of the federal secondary market agencies to this end.

Public policy should aim to preserve the cloth of this housing finance tapestry. But public policy needs also to remove inducements to abuse the privileges of federal backing and to build monitoring and enforcement capacity adequate for the scale of today's financial markets. Public policy should encourage healthy competition on a level playing field among mortgage market participants. Public policy should focus on financing current housing transactions, not the churning of already outstanding debt. And it should work toward breaking down artificial barriers that prevent mortgage companies, thrifts, plus banks, from jointly offering a full range of housing-related financial services as well as underwriting and distributing mortgage securities instruments.

These are the designs for weaving an assurance of a more steady and adequate supply of housing credit of lowest possible cost to tomorrow's home-buying and renting public.

C6 SUNDAY, MARCH 6, 1988

The Washington Post

Insolvent S&Ls

WITHIN the savings and loan industry, the unpleasant arithmetic of the cleanup keeps intruding on the optimists' hopes. No one knows exactly how much it will cost to shut down the hundreds of insolvent S&Ls. They are still open and taking deposits from the public because the federal regulators have not had the money to pay off their debts and padlock them. Congress enacted legislation last summer to inject a special transfusion of $10.8 billion into the S&L deposit insurance fund, which at that point, because of the huge losses in the industry, was also insolvent.

Perhaps the resources now available will suffice to put the failed S&Ls out of business. But perhaps not, for the losses of the insolvents are continuing on a very large scale. A lot depends on the prices of oil and wheat and on business conditions in the Southwest. As the Federal Home Loan Bank Board has pointed out, the S&Ls in distress are heavily concentrated in Texas. Nearly a third of the insolvent institutions and nearly two-thirds of the recent losses are in that one state alone. There you can see the results of a long history of loose state regulation, compounded by the decline in the regional economy.

So far it has been the S&L industry itself that has put up the money to restore the insurance fund, through present and future premiums on its deposit insurance. But that has pushed the S&Ls' premiums 2½ times as high as those paid for similar insurance by the banks with which they compete. If these premiums can't be raised further, how else could the cleanup be financed?

One perennial suggestion—and a bad one—is to merge the two deposit insurance funds. That would merely weaken the banks' fund by forcing it to take over the S&L system's liabilities. Perhaps the financial institutions can't pay for a rescue operation of the size now necessary. The last resort would be, as usual, federal money.

It may come to that—a bail-out by the taxpayer. After years of denying that it would ever be needed, the industry's strategists are now tentatively beginning to discuss it. But if closing down the insolvent S&Ls requires public money, that should be a signal that the S&L industry is no longer viable. At that point it would be no more than good sense to require the healthy S&Ls to convert themselves into commercial banks, under banking regulation, and to abolish the traditional S&L system on grounds that it is too fragile, too unstable and too expensive to survive in the present economy.

Federal Home Loan Bank Board
OFFICE OF THE CHAIRMAN

M. DANNY WALL, Chairman

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

July 22, 1988

The Honorable William Proxmire
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Dear Chairman Proxmire:

Attached is the transcript from the April 27, 1988, hearing before the Committee on S. 2073, the Thrift Charter Enhancement Act. It contains corrections to my testimony that I would appreciate having incorporated into the printed record.

At three points during the hearing, while responding to questions from members of the Committee, I indicated that I would provide additional material for the permanent record. The following information is intended to address those situations.

In response to a question from Senator Karnes regarding the percentage of the problems in the thrift industry that are caused by federally chartered institutions as opposed to state chartered institutions (page 37 of the transcript), I indicated that the preponderance of FSLIC's problems have historically been caused by state chartered institutions; but that I would provide a more specific statistic for the record. Current data indicates that during the period from 1980-1987, FSLIC resolved 318 problem institutions; of this total, 173 were state chartered institutions and 147 were federally chartered. The estimated net present value ("NPV") cost to FSLIC of resolving the problems of those state chartered institutions ($7.06 billion) exceeded the estimated NPV cost of resolving the federally chartered institutions ($4.63 billion) by $2.43 billion.

Senator Cranston requested a list of provisions that could be added to S. 2073 to better protect the safety and soundness of thrifts (page 39). The Bank Board is considering various legislative and regulatory initiatives to protect the safety and soundness of FSLIC insured institutions. As I indicated in my testimony, however, we do not believe that this is the appropriate time to advance this legislation and for this reason are not recommending that any additional provisions be added to the bill.

Finally, in response to Senator Graham's question regarding the acquisition of four troubled institutions by the Statesman Group, Inc. (page 46), I have attached a copy of an analysis of that acquisition that was prepared by the Board's Office of General Counsel.

I believe this material should complete the Bank Board's contribution to the hearing record on H.R. 2073. Should you require additional information, however, please do not hesitate to let me know.

Sincerely,

M. Danny Wall
Chairman

Federal Home Loan Bank Board

Memo

OFFICE OF GENERAL COUNSEL

INTER-OFFICE COMMUNICATION

TO: Office of Regulatory Policy, Oversight and Supervision

FROM: Corporate and Securities Division, Office of General Counsel

DATE: March 11, 1988

SUBJECT: Savings and Loan Holding Company Application on Form H-(e)1

by

The Statesman Group, Inc. and its wholly owned subsidiary American Life and Casualty Insurance Company (collectively the ("Applicant")

to acquire control with FSLIC financial assistance, of

First Federated Savings Bank
West Palm Beach, Florida
FHLBB No. 6823

First Federal Savings Bank
Waterloo, Iowa
FHLBB No. 2321

Peoples Federal Savings and Loan Association
Waterloo, Iowa
FHLBB No. 5965

and

The Perpetual Savings and Loan Association
Waterloo, Iowa
FHLBB No. 4477

LEGAL OPINION

I. ISSUE PRESENTED

Whether the Federal Home Loan Bank Board ("Board"), as operating head of the Federal Savings and Loan Insurance Corporation ("FSLIC"), has the legal authority to approve the subject application and the acquisition and transactions related or incidental thereto, and the waivers and forebearances requested in connection therewith, in accordance with applicable provisions of the Savings and Loan Holding Company Amendments of 1967, as amended ("Act"),[1] the Home Owners' Loan Act of 1933, as amended ("HOLA"),[2] and pursuant to the Board's regulations thereunder.[3]

II. CONCLUSION

In our opinion the Board has the legal authority to approve the applications and most of the requested waivers and forebearances subject to the conditions recommended herein and the conditions recommended by the Office of Regulatory Policy, Oversight and Supervision ("ORPOS") and by the Supervisory Agent of the Federal Home Loan Bank of Des Moines (the "SA"). The application must be acted on by the Board and may not be acted upon under delegated authority by the Board's staff since the application involves FSLIC financial assistance, a receivership and the Applicant has refused to sign the standard regulatory capital maintenance agreement and has requested a waiver under § 408(m) of the NHA of the provisions of state law, applicable transactions with affiliate statutes and regulations, including the cross-marketing provisions of § 408(p) of the NHA, all of which raise significant issues of law and policy. 12 C.F.R. 574.8(b).

III. FACTS

A. The Proposal

The Statesman Group, Inc., ("Statesman") proposes to consolidate and acquire First Federated Savings Bank, West Palm Beach, Florida; First Federal Savings Bank, Waterloo, Iowa, Peoples Federal Savings and Loan Association, Waterloo, Iowa; and The Perpetual Savings and Loan Association, Waterloo, Iowa, through a supervisory acquisition assisted by the Federal Savings and Loan Insurance Corporation ("FSLIC").

1/ 12 U.S.C. § 1730a (1982).

2/ 12 U.S.C. § 1462 et seq. (1982).

3/ 12 C.F.R. Parts 541 through 556, 574, and 584 (1987).

The acquisition would be accomplished through the following series of steps. Statesman would establish and incorporate Statesman Savings Holding Corp., (the "Holding Company"). Voting control of the Holding Company would pass to American Life and Casualty Insurance Company (the "Insurance Company"), Stateman's wholly-owned subsidiary, by virtue of the common stock it would receive in exchange for its $8.4 million cash contribution to the Holding Company. The Applicant's total contribution to the Holding Company would be $21 million. The Holding Company will establish and incorporate Statesman Bank for Savings, FSB, a wholly-owned subsidiary federal savings bank (the "Institution"). The capital to be infused into the Holding Company would be contributed by that entity to the Institution. The Institution would then purchase and assume substantially all of the assets and liabilities of First Federated Savings Bank from the FSLIC as receiver for that institution. This would be followed by the merger of the remaining three associations into the Institution. As part of the proposed acquisition, financial contributions are to be made to the resulting Institution by both the Applicant and by the FSLIC.

The Applicant will enter into a Regulatory Capital Maintenance/ Dividend Agreement with the FSLIC which would limit the amount of capital that they would be required to contribute to $4 million. See discussion in Section IV.A.12., infra.

B. Background of the Parties

1. The Applicants

a. Statesman Group, Inc.

Statesman is a holding company incorporated in Delaware with its principal executive offices in Des Moines, Iowa. Through its subsidiaries, Statesman engages primarily in the business of life insurance and, to a lesser extent, in the business of investment banking and retail brokerage and property-casualty insurance. In addition, in January, 1987 Statesman, through a 60 percent owned subsidiary, purchased all of the stock of Statesman Mortgage Company ("Statesman Mortgage") which originates, sells and services mortgages in several states.

b. American Life and Casualty Insurance Company

American Life and Casualty Insurance Company is a wholly-owned subsidiary of Statesman engaged in the life insurance business. The company is an applicant by virtue of the fact that it will control all other outstanding stock of Statesman Holding Company.

2. The Associations

a. First Federated Savings Bank

First Federated Savings Bank of West Palm Beach, Florida is a state chartered stock institution, having converted to stock form in 1978. First Federated has incurred substantial losses in recent years, is currently insolvent and had regulatory capital of negative $36 million at September 30, 1987.

b. First Federal Savings Bank

First Federal Savings Bank of Waterloo, Iowa is a federally chartered mutual association. As of December 31, 1987 the institution had a negative net worth of ($44.4 million) and has a continuing trend of monthly operating losses. The majority of its losses are the result of the institution's investments in large commercial real estate loans. The Board of Directors and President were replaced on November 5, 1987.

c. Peoples Federal Savings and Loan Association

Peoples Federal Savings and Loan Association of Waterloo, Iowa is a federally chartered mutual association. The institution is operating under a Supervisory Agreement which was signed by its directors in August of 1986. As of December 31, 1987 the association had a negative net worth of ($2.4 million).

d. The Perpetual Savings and Loan Association

The Perpetual Savings and Loan Association of Waterloo, Iowa is a state chartered mutual association. As of December 31, 1987 the institution had a negative net worth of ($4.7 million).

IV. LEGAL ANALYSIS

A. Savings and Loan Holding Company Act

1. Applicability of the Act

Section 408(e)(1)(B) of the Act, 12 U.S.C. § 1730a(e)(1)(B) (1982), requires a company to obtain the prior approval of the FSLIC before acquiring control of an insured institution. The Applicant would control the Association through the Holding Company which would directly own 100 percent of the voting shares of the Institution. Accordingly, the Applicant and the Holding Company will be savings and loan holding companies upon consummation of the proposed acquisition and must obtain written approval from the Board prior thereto.

2. Acquisition Standards

a. Financial and Managerial Resources and Future Prospects; Antitrust Considerations

The Act directs the FSLIC in reviewing a proposed acquisition of an insured institution by a company to consider the financial and managerial resources and future prospects of the company and institutions involved and the convenience and needs of the communities involved and to determine whether the acquisition would be detrimental to the insured institution or to the insurance risk of the FSLIC,[4/] a standard that involves a significant exercise of judgment and discretion by the Board.

Denial of an acquisition of an insured institution also is required if the acquisition would violate certain federal antitrust laws.[5/] The Community Reinvestment Act also provides specific legal grounds for denial if the acquiror or the acquired institution is not in compliance with that Act.[6/]

We are aware of no grounds compelling denial of the subject application under the above described standards and we defer to ORPOS to further advise the Board regarding the financial and managerial resources, and future prospects, of the Applicant and the Institution and the convenience and needs of the communities to be served by the Institution.

b. Limitation of NOL Carryforwards

Section 408(e)(4) of the NHA, as amended, permits and in and some cases requires the Board to consider the likelihood of an acquisition causing an association to lose its net operating loss carryforwards under section 382 of the Internal Revenue Code of 1986 ("IRS Code"). In the present case, however, consideration is not mandatory because the acquisition is a supervisory case being approved under § 408(m). We defer to ORPOS further to advise the Board as it deems appropriate with regard to any potential loss of NOLS.

3. Waiver Authority Under Section 408(m)

As discussed below, it is our opinion that the Board has a legal basis to invoke Section 408(m) of the Holding Company Act in connection with the subject acquisition to grant various waivers requested by Statesman. The FSLIC was granted extraordinary

---

4/ 12 U.S.C. § 1730a(e)(2) (1982).

5/ Id.

6/ 12 U.S.C. §§ 2901 et. seq. (1982).

authority by Section 408(m) to authorize the acquisition and merger of failing insured institutions notwithstanding the provisions of any other state or federal law, with certain limited exceptions. Section 408(m)(1)(A) of the NHA provides in pertinent part that:

> Notwithstanding any provisions of the laws or constitution of any State or any provision of Federal Law, except [certain provisions of § 408 not pertinent here] the [FSLIC] upon its determination that severe financial conditions exist which threaten the stability of a significant number of insured institutions or of insured institutions possessing significant financial resources, may authorize, in its discretion and where it determines such authorization would lessen the risk to the [FSLIC], an insured institution that is eligible for assistance pursuant to section 406(f) of the [NHA] to merge ... with ... any other insured institution, ..., [or] may authorize any other insured institution ... or company to acquire control of said insured institution.

Section 408(m)(3) requires the Board to consider the need to minimize the cost of financial assistance and the need to maintain specialized depository institutions and establishes certain priorities among various proposals to acquire the target association being considered by the FSLIC under Section 408(m). Those priorities run from first priority accorded to proposals from thrift institutions or holding companies thereof located in the same state as the target institution and from private investors[7/] to fourth priority for proposals by commercial banks or holding companies thereof located in a different state.

Section 408(m)(3)(C), (D) also provides that, if the target association is a minority controlled institution, that offers from other minority controlled institutions must be solicited and that when considering proposals from out-of-state bidders, priority shall be given offers from adjoining states.

Section 408(m)(1)(B) requires the Board to give the state official having jurisdiction over the acquired institution written notice of the Board's use of 408(m) 48 hours prior to consummation of the transaction. If the state official objects to the use of 408(m) within 48 hours of the notice, the use of 408(m) by the FSLIC is permitted only if approved by all three members of the Board. The provisions of 408(m) requiring prior notice to the State Official

---

7/ See Getty v. FSLIC, 804 F.2d 1050 (D.C., 1986).

would not appear to be relevant where the target insolvent institution is federally chartered and the acquiring corporation is also federally chartered.

The memoranda from the FHLBanks of Des Moines and Atlanta clearly show that (1) the Associations are insolvent on a GAAP and RAP basis; therefore they are eligible for FSLIC assistance under § 406(f) of the NHA; and (2) severe financial conditions exist which threaten the stability of a significant number of insured institutions or of institutions possessing significant financial resources. Therefore, in our opinion the Board has the authority to use Section 408(m) and the predicates to the use of Section 408(m) have been satisfied.

The language of the Section 408(m) of the Act itself places certain restrictions on its use but does not prohibit the use of the section to waive the provisions at issue here. The legislative history of the section offers very little guidance on any other intended limitations on the scope of Section 408(m). The legislative history of the provision, for example, refers primarily to the section's use in overriding statutory barriers to an acquisition transaction itself, not other statutory or regulatory provisions that effect the manner in which the acquisition would occur and the regulation of the institution and its acquiror after the acquisition. However, Congress apparently did envision that Section 408(m) could be invoked in respects involving activities restrictions applicable to holding companies. As explained by the Senate Banking Committee in its report on the Senate version of the 1982 legislation:

> "This section allows the FSLIC, regardless of any other law (except antitrust law) to authorize an insured institution eligible for FSLIC assistance to merge with any other insured institution or a FDIC-insured bank, or to be acquired by any holding company. This would enable the FSLIC to arrange mergers of institutions across state lines notwithstanding interstate branching prohibitions, and to let holding companies acquire institutions other than in their home State, and without regard to normal activities restrictions."[8]/ (emphasis added).

A broad use of Section 408(m) authority would not necessarily offend any of the concerns that were foremost in the mind of Congress in granting the authority: resolution of supervisory cases at the lowest possible cost to the FSLIC and a disfavor of interstate and/or interindustry acquisitions. Indeed, with respect to the latter consideration, a dominant theme in the legislative history of Section

---

[8]/ S. Rep. No. 536, 97 Cong., 2d Sess. 49.

408(m) is that the Board's Section 408(m) authority be invoked to permit interstate or interindustry acquisitions only as a last resort.9/

In fact, prior to CEBA, Section 408(m) was used to override interstate branching prohibitions, to permit interstate acquisitions by savings and loan holding companies, and to allow unitary holding companies that become multiples as a result of a supervisory acquisition not to be subject to the activities restrictions usually applicable to multiple holding companies. The section also was used to override limitations contained in the Home Owners' Loan Act of 1933 on the powers and investment authority of federal savings institutions in order to allow an institution to be recapitalized through the infusion of amounts or types of assets that the institution otherwise would not be permitted to hold, and to override transactions with affiliates prohibitions that would normally apply where an acquiror asserted that the income to be generated for the institution from those transactions was a key to the plan for the institution's financial recovery.

More recent legislative history, of amendments to Section 408(m) adopted as part of the Competitive Equality Banking Act of 1987 ("CEBA") offer some additional enlightenment on the scope of Section 408(m). A passage from the CEBA Conference Report summarizes Section 408(m) as follows:

> "Section 408(m)(A)(i) preempts other provisions of Federal and State law that would have the effect of preventing a company from acquiring a failing thrift institution. Thus, for example, if a life insurance company invested in or acquired a thrift institution under section 408(m), that section would preempt any State law that would prevent the company from continuing to engage in the life insurance business because of that investment or acquisition. That section would not, however, preempt State restrictions on

---

9/ 127 Cong. Rec. H7795 (daily ed. October 27, 1981) (remarks of Rep. Wylie) (". . . the bill contains safeguards to insure that the regulators will pursue interstate and interindustry mergers only as a last resort"); 127 Cong. Rec. H7798 (daily ed. October 27, 1981) (remarks of Rep. Vento); 128 Cong. Rec. H8437 (daily ed. October 1, 1982) (remarks of Reps. Perkins and Stanton); 128 Cong. Rec. S12214 (daily Ed. September 24, 1982) (statement of Sen. Riegle); see also S. Rep. No. 97-536, 97th Cong. 2d Sess. at 7 (1982); H.R. Rep. No. 97-272, 97th Cong. 2nd Sess. at 11 (1982); H.R. Rep. No. 97-641, 97th Cong. 2nd Sess. at 85 (1982) (The Garn-St Germain Act provides "specific procedures for the agenc[y] . . . to follow in order to facilitate the acquisition or merger of failed or failing institutions.")

the percentage of an insurance company's assets that may be invested in any one subsidiary, or similar type safeguards."[10]/

Although oblique, the foregoing language appears to indicate a Congressional recognition that Section 408(m) may be used to override provisions of Federal and State law that would effectively prevent a company from acquiring a failing institution by forbidding that company from continuing its past activities, as well as those that would effect a structural bar to the acquisition. The life insurance company situation provides an example of a law that would act as an impediment, but not an outright bar, to the ability of a company to make a supervisory acquisition. Moreover, the example could be read as supporting the use of Section 408(m) to enable an acquirer to conduct its business in the same manner as it could have been conducted, but for having made the supervisory acquisition. However, as the example illustrates, this "but for" analysis would not carry so far as to support use of Section 408(m) to override substantive industry regulation that was applicable to a company prior to its acquisition of a savings institution. Nor would it seem appropriate to utilize the authority under Section 408(m) to waive or override statutory provisions which in and of themselves do not present material impediment to the consummation of the transaction or which are wholly unrelated to the acquisition or to the rehabilitation of the insured institution.

4. Transactions With Affiliates

In connection with the subject acquisition, the Applicant has requested that the Board invoke Section 408(m) of the Holding Company Act in order to waive certain regulatory restrictions which would apply to its contemplated transactions with affiliates. Such transactions would include among other things, the Institution serving as a depository for funds of the Applicant, Statesman Mortgage servicing some of the loans originated or acquired by the Institution, purchases by the Institution of GNMA and similar securities directly from Statesman Mortgage, the Institution providing a line of credit for Statesman Mortgage and Statesman and its affiliates providing management and various other services to the Institution for a fee.

We believe that the Board would have a legal basis to invoke Section 408(m) of the Act to waive the various regulatory and statutory prohibitions and limitations to which such transactions are subject (e.g. § 408(p)(1)(d), 12 C.F.R. 563.41, .43, 583.4), since "but for" the Applicant's acquisition, such activities would not have been prohibited or limited. Furthermore, we believe that such prohibitions and limitations, which would have an immediate impact on transactions involving the Applicant, Statesman Mortgage and the

---

[10]/ H.R. Rep. No. 100-261, 100th Cong. 1st Sess. at 140.

Institution, could, for that reason, be characterized as being a material impediment to the proposed transaction and projected plan of restructuring. Therefore, in our opinion, § 408(m) can be utilized to waive the forgoing statutes and regulations. (The availability of Section 408(m) is discussed in Section IV.A.3. herein.) However, while the affiliated transactions regulations are waivable under Section 408(m), we defer to the SA and to ORPOS to further advise the Board as to whether there are any supervisory issues involving the proposed transactions, or to determine what conditions would be appropriate to ensure that these transactions would not have a negative impact on the safety and soundness of the Institution.

5. Cross-Marketing

As part of the proposed acquisition, the Applicant has requested the Board to invoke Section 408(m) to waive the limitations on cross-marketing imposed by Section 408(p)(2) of the Holding Company Act.[11/] Section 104(d) of the CEBA introduces a new Section 408(p) to the Holding Company Act, which states that "Notwithstanding any other provision of this Section [Section 408] an insured institution subsidiary of a diversified savings and loan holding company may not offer or market products or services of an affiliate that are not permissible for bank holding companies to provide under section 4(c)(8) of the Banking Holding Company Act of 1956 or permit its products or services to be offered or marketed by or through an affiliate . . ." except under certain circumstances, which are not pertinent to the subject request.

As a threshold matter, a question is presented as to whether Section 408(p) may be waived by the Board. It might be argued, for example, that the "notwithstanding" language contained in Section 408(p) was not waivable pursuant to the exercise of the Board's extraordinary powers under Section 408(m). In our view, however, use of section 408(m) to waive Section 408(p) is not precluded. The most telling support for this position is the language of section 408(m) itself, which bars use of the section to waive certain subsections of section 408, but not subsection 408(p). More importantly, at the time Congress enacted CEBA and added § 408(p) to § 408 it also added additional references in § 408(m) to provisions of § 408 that could not be waived by § 408(m) but did not include a specific reference to § 408(p). Thus, Congress specifically excluded sections of the Holding Company Act from the scope of Section 408(m) but did not do so in the case of subsection 408(p). Also, on the basis of our review of the legislative history of subsection 408(p), we find no indication of Congressional intent that the section was intended to be non-waivable.

11/ 12 U.S.C. § 1730a(p)(2).

Statesman intends to sell its insurance products and services through the facilities of the Institution. Under this arrangement, insurance products and services would be sold on the premises and by the employees of the Institution. For these marketing efforts the institution and/or its employees would receive payments from the Statesman insurance affiliates at some contractually determined rate.

In addition, R.G. Dickinson & Co., which is an investment and banking retail brokerage business subsidiary of Applicant, proposes to participate with the Institution in providing additional investment opportunities to customers of the Institution. A desk would be established at one or more of the facilities of the Institution and staffed by an employee-broker of R.G. Dickinson & Co. for the purpose of engaging in general broker-dealer transactions such as the buying and selling of stocks, bonds, mutual funds and other investments normally dealt in by R.G. Dickinson & Co.

The Institution's base of customers would also be referred by telephone to R.G. Dickinson & Co. for investment services. R.G. Dickinson & Co., would, in situations where its fees were competitive, act as the trader on permitted investments of the Institution. Any activities between R.G. Dickinson & Co. and the Institution and its customers would be under the same terms, conditions and rates which are now applicable between R.G. Dickinson & Co. and other institutional and individual customers.

The Applicant contends that the cross-marketing activities between the Institution and Applicant would be beneficial to the Institution because the Institution could offer directly to its customers additional financial products and services through affiliated companies. The expanded scope of financial services which could be made available to the customers would be of assistance in retaining the existing customer base and enlarging that base, thereby resulting in increased deposit volume. Additionally, the Institution would generate commissions when it engages in sales activities for the account of affiliated companies.

In our opinion, the Board may invoke Section 408(m) to waive the cross-marketing restrictions that would otherwise be applicable to Statesman and its affiliates pursuant to Section 408(p). This conclusion is based on the fact that "but for" the contemplated acquisition, the provisions of 408(p) would not apply to those entities. In addition, since Statesman is predominately an insurance company, its ability to market its products through the facilities of the Institution, which has been presented an integral part of the transaction, would be immediately effected and restricted. Thus, the operation of the 408(p)(2) restrictions would have a material impact on Stateman's ability to conduct its business as permitted prior to the acquisition and thus the imposition of cross-marketing restric-

tions would be a material impediment to the acquisition. Accordingly, it is our view that Section 408(m) can be utilized to override section 408(p).

Having waived the Section 408(p) prohibitions, we defer to the SA and to ORPOS as to whether there are supervisory concerns which would warrant that such waiver be subject to any conditions.

However, as to the securities affiliation, since this Office has played a role in advising the Board with respect to issues presented by affiliations between securities firms and thrift institutions, we would recommend that the Board consider conditioning its approval of the application upon certain requirements designed to establish certain basic safeguards, and in some cases a "firewall" between the traditional thrift operations and the securities affiliate's activities. We have included, for the Board's consideration, an example of conditions which could be imposed. Such conditions are based on the various "firewall" provisions which have been introduced in bills pending before Congress, and can be found in Attachment "A" to to this opinion.

6. Waiver of State Law

Section 408(m) of the National Housing Act authorizes the FSLIC to authorize merger or acquisition transactions, "Notwithstanding any provisions of the laws or constitution of any state . . .". See Section 408(m)(1)(A). Such authority could preempt any current or future state laws which would limit or preclude the affiliation of the Institution and Statesman or any of its insurance affiliates or would, by reason of such affiliation, prohibit the sale of insurance by Statesman, its insurance affiliates or agents. The parameters of this preemptive authority are addressed in the Competitive Equality Banking Act of 1987 Conference Report which indicates that Section 408(m) would permit the Board to waive any state law that would prevent a life insurance company from continuing to engage in its business because of an acquisition made under that section. See section IV.A.13. herein at page 14. Since "but for" the contemplated acquisition, Statesman would be able to conduct its insurance businesses unimpeded by such state laws, in our opinion, Section 408(m) can be used to override such state laws. If such laws were permitted to remain in effect, they would be a material impediment to Statesman and the proposed acquisition. However, consistent with the recent legislative history on 408(m) in CEBA, See section 3 supra, we recommend that such waiver not extend to state law safeguards such as limitations on the investment amount in any one subsidiary, provided such safeguards are not predicated on the subsidiary being involved in the savings and loan or banking business.

7. Debt Approval

Section 408(g) of the Holding Company Act[12/] limits the amount of debt that a non-diversified savings and loan holding company and any subsidiary thereof which is not an insured institution may issue, sell, renew or guarantee without the prior approval of the FSLIC.

As a "diversified savings and loan holding company"[13/] Statesman is exempt from the limitations on holding company indebtedness of Section 408(g) and the Board's holding company debt regulations, 12 C.F.R. § 584.6(1987). In connection with the subject transaction, however, Statesman has requested a waiver of all future holding company debt approval requirements in the event that Statesman fails to qualify as a diversified holding company. Statesman is concerned that given the size of the Institution, its successful operation and growth could cause Statesman to become a non-diversified institution subject to debt restrictions.

It is clear that but for the proposed acquisition Statesman would not be subject to the debt restrictions from which it is seeking relief. However, since Statesman would be a diversified holding company and accordingly would not become subject to debt control after the acquisition, such restrictions do not represent a material impediment either to Statesman or to the acquisition transaction. In fact, the debt restrictions may never apply to Statesman or its affiliates. This being the case, we do not believe that the Board may utilize the authority under Section 408(m) to waive Section 408(g). We, however, defer to the SA and ORPOS to address any supervisory concerns on this issue. We note in this regard that the SA has recommended that an annual budget approval process be instituted.

8. Prohibited Acquisitions and Corporate Structures

The Act prohibits a savings and loan holding company from (1) owning any voting shares in an insured institution that is not its subsidiary, [14/] (2) controlling an uninsured institution,[15/] and (3) controlling an insured institution in mutual form.[16/] The Act also prohibits the FSLIC from approving an acquisition that would (1) result in the formation of a multiple savings and loan holding com-

---

12/ 12 U.S.C. § 1730a(g).

13/ 12 U.S.C. § 1730a(a)(1)(F).

14/ 12 U.S.C. § 1730a(e)(1)(A)(iii) (1982).

15/ 12 U.S.C. § 1730a(e)(1)(A)(iv) (1982).

16/ 12 U.S.C. § 1730a(i) (1982).

pany controlling insured institutions located in more than one state.[17/] The proposed acquisition does not raise any issues regarding any of the prohibited corporate organizations or structures noted above.

9. Activities Restrictions

The Holding Company Act restricts the activities of savings and loan holding companies and their subsidiaries. See 12 U.S.C. § 1730a(c)(1) (1987). The Holding Company Act activities restrictions apply to a holding company controlling a single insured institution only if the insured institution subsidiary controlled by the savings and loan holding company is not a "qualified thrift lender" ("QTL") as defined in 12 U.S.C. § 1730a(o). The Board has taken the position that all insured institutions are qualified thrift lenders as of January 1, 1988, and, accordingly, the earliest date at which an insured institution may fail the qualified thrift lender test is July 1, 1989. Thus, the earliest date the Institution could lose its qualified thrift lender status (and the Applicants would become subject to the restrictions of section 408(c)) would be July 1, 1989.

10. Antitrust

Section 408(e)(2) of the Act prohibits the approval of any proposed acquisition of an insured institution which would result in a monopoly or further any attempt to monopolize the savings and loan business in any part of the country or that would have the effect of substantially lessening competition or be in restraint of trade. [18/] The Applicant is not presently engaged in the savings and loan business, and does not control any other depository institution or otherwise compete with the Association in the savings and loan business. Therefore, in our opinion, approval of the application would not result in any of the anti-competitive situations prohibited by the Act. [19/]

In addition, before approving the acquisition of an insured institution by an existing savings and loan holding company or an acquisition of more than one insured institution by any company, the FSLIC is required to request from the Attorney General, and consider any report rendered within 30 days, on the competitive factors involved. A copy of that report, which takes no exception to the acquisition, is attached as Exhibit "A". In conclusion, we have no legal objection on anti-competitive grounds to approval of this transaction.

[17/] 12 U.S.C. § 1730a(e)(3)(A) (1982).

[18/] 12 U.S.C. § 1730a(e)(2) (1976).

[19/] Id.

a. Direct Competition

First Federal Savings Bank, Waterloo, Iowa ("First Federal") has its home and 4 branches in Black Hawk County, Iowa with 9.3% of the total deposit shares in that county; 1 branch office in Fayette County with 15.3% of the total deposit shares in that county and 1 branch office in Dubreque County, Iowa.

Perpetual Federal Savings and Loan Association, Waterloo, Iowa ("Perpetual") has its home and 2 branches in Black Hawk County with 4.9% of the total deposit shares in thet county, 3 branches in Bremer County, with 12.6% of the total deposit shares in that county; 1 branch in Bulter County, 1 branch in Grundy County and 1 branch in Buchanan County, Iowa.

Peoples Federal Savings and Loan Association, Waterloo, Iowa ("Peoples") has its home and 3 branches in Black Hawk County, Iowa with 6.4% of the total deposit shares in that county; 1 branch in Fayette County with 4.6% of the total deposit shares in that county; 1 branch in Bremer County with 2% of the total deposit shares in that county, and 1 branch in Chickasaw, Delaware Tamand Clayton Counties, respectively.

After the acquisition, the resulting association will have 20.6%, 19.9% and 14.6%, respectively of the total deposit shares in Black Hawk County, Fayette County, and Bremer County, Iowa.

b. Faltering/Failing Company Doctrine

However, any adverse effect on competition would be mitigated by the weak financial conditions of First Federal, Perpetual and Peoples. An antitrust analysis must consider the dynamics of the market and the real competitive strength in that market.

The Supreme Court has determined that a firm's probable future ability to compete is more important than its current market share based on past performance.[20/] First Federal, Perpetual and Peoples are insolvent. Thus, irrespective of their shares of deposits or lending, they have been unable to compete in the market on a profitable basis. Therefore, the effect on competition of the acquisition of First Federal, Perpetual and Peoples is probably procompetitive as it will return active competitors to the market involved.

[20/] United States v. General Dynamics, 415 U.S. 486, 503 (1974).

Moreover, this transaction may also be analyzed under the failing company doctrine.[21]/ Given the unavailability of any other economically feasible quantifiable alternatives in this case,[22]/ we conclude that the requirements of the doctrine are met and that it may operate as a defense to any action brought as a result of this transaction which alleges a violation of the antitrust laws.

In sum, in our opinion the proposed transaction would not violate the antitrust laws and we have no legal objections to approval of this transaction on any other antitrust grounds.

11. Securities Certification

Section 408(r) of the Holding Company Act expired on March 1, 1988; therefore, there is currently no statutory prohibition relating to affiliations between insured institutions and organizations engaged principally in certain securities activities. Had the section survived the affiliation between the Institution and Statesman's broker/dealer subsidiary would have been exempt pursuant to Section 408(r)(2)(D) because such institution would have had total assets of more than $500,000,000 at the time of the acquisition.

The Applicant has not provided the currently required securities certification, in the form specified in Memorandum SP-51, regarding underwriting or market-making activities in corporate equity or debt securities. The Board would appear to have several options with respect to its securities affiliation policy in the context of the subject application. For our recommendations see Section IV.A.5. herein, and Attachment "A".

12. Regulatory Capital Maintenance and Dividend Limitation

In connection with the acquisition, the Applicant will enter into a "dollar cap" type of Regulatory Capital Maintenance obligation with an attendant "prenuptial agreement" which allows for control of the institution to revert to the FSLIC should the holding company be unwilling to infuse additional capital when the institution's capital falls below a minimum requirement. Specifically, the capital maintenance agreement is limited to (1) an agreement on the part of the Applicant to infuse capital in order to maintain the regulatory capital of the Institution at a level consistent with that required by 12 C.F.R. § 563.13(b), provided that the aggregate amount of this obligation not exceed $4 million; and (2) an agreement that in the event the Institution's ratio of regulatory capital to total liabilities falls below 2 percent,

---

21/ See International Shoe v. FTC, 180 U.S. 291 (1930); Grandader v. Public Bank, 281 F. Supp. 120 (E.D. Mich. 1967).

22/ See the OFSLIC Issues memo.

without prompt remedy, the FSLIC will have the right to vote the securities acquired by the Applicant and the Holding Company, remove the Institution's board of directors, and/or sell the Institution to a new owner. The Board's standard provision prohibiting dividends in any fiscal year in excess of 50 percent of the institution's net income will be included in the agreement.

In our opinion, the requested conditions regarding regulatory capital maintenance and dividend restrictions are well within the Board's authority to grant under Section 408 of the Holding Company Act. The use of such conditions by the Board in connection with its statutory duty to consider the financial resources and future prospects of the holding company and of the target institution has been clearly upheld by the courts. See, Kaneb Services v. Federal Savings and Loan Insurance Corporation, 650 F.2d 78, 83 (1981). Moreover, the terms of the statutory provisions of the Act authorizing the FSLIC to provide financial assistance pursuant to "such terms and conditions as (it) may prescribe," provides added support for the imposition of those conditions in this case.[23/] This is an area where the Board possesses substantial discretion and we have no legal objection to the agreement. We defer to ORPOS to further advise the Board, if necessary, regarding this issue.

13. Forbearances

The Applicant has requested a number of standard forbearances pursuant to Memorandum SP-37a. We have no legal objection to Board approval of any of these forbearances or waivers but defer to ORPOS to advise the Board with respect to these issues.

B. Home Owner's Loan Act Approvals

The proposed transaction does not require any Board approval pursuant to the provisions of the HOLA. See 12 U.S.C. §§ 1461-1470 (1982).

23/ 12 U.S.C. § 1729(f) (1982).

C. Interstate Branching Issues

As a result of the acquisition, the Institution will have branching rights in Florida as well as in Iowa, the state in which its home office will be located. Section 556.5(a)(3)(ii) authorizes such branching rights for supervisory cases.[24]/

D. Chartering, Merger, Conversion

The proposed transaction contemplates the appointment of the FSLIC as sole receiver for First Federated Savings Bank pursuant to § 406(c)(1)(B) of the NHA (12 U.S.C. Section 1724) et seq. As discussed above, the FSLIC will organize the Institution, a new federal stock-form savings and loan association, pursuant to §§ 406(a) and 406(b)(1) of the NHA, for the purpose of acquiring the assets and liabilities of First Federated Savings Bank. The FSLIC will place the Institution under the ownership and control of the Applicant. Given the insolvency of First Federated Savings, we would raise no objection to the Board approving the issuance of the charter under 406 of the NHA.

The proposed acquisition also involves the conversion and merger of the three mutual associations in Iowa from federally-chartered mutual associations to a federal stock association by merger into the Institution. Conversions from a mutual-to-stock from of organization are subject to § 5(i), (p) of the HOLA, § 402(j) of the NHA and the Board's conversion regulations at 12 C.F.R. Part 563b.3. The Board's conversion rules, however, expressly provide that the Board may waive any otherwise applicable provision of those rules in dealing with a supervisory transaction. See 12 C.F.R. §§ 563b.1(a)(1), .20. Therefore, based on the supervisory nature of this case as set forth in detail in the "S" Memorandum supplied by ORPOS, we have no legal objection to waiver of provisions of Part 563b in the Board Resolution. However, as previously noted, the antitakeover protection under § 563b.10 is not being waived. Nevertheless, we note that based on a memorandum from ORPOS, in our opinion, the three largest mutual associations would qualify for voluntary supervisory conversion to stock form pursuant to the eligibility standards set forth at 12 C.F.R. § 563b.24. In our opinion, the aforesaid memoranda from ORPOS and the OFSLIC would enable the Board to make the following findings with respect to each of the three Iowa based mutual associations, pursuant to § 563b.24:

24/ As proposed, the acquisition of the former branches of target associations would qualify for the supervisory exception in § 556.5(a)(3)(ii) because the acquisition would be FSLIC-assisted. (i.e., constitutes an action pursuant to the FSLIC) and it would reduce the FSLIC's cost or risk, (i.e., the FSLIC cost would be less than its cost of liquidating those associations). See, the OFSLIC memorandum.

(a) the Association's liabilities exceed their assets, as calculated under generally accepted accounting principles on a going concern basis, and

(b) the Association would be a viable entity upon consummation of the conversion as determined under § 563b.26.

The Institution will be chartered under § 406 with a home office designated in Des Moines, Iowa, with approval of the specific location of that home office in Des Moines to be obtained from the PSA. Upon consummation of the Institution's combination with the four target associations the Institution's home office would be temporarily redesignated as one of the former home offices of one of the 3 target Iowa based associations, pending final approval of the Des Moines home office location by the PSA. In our view, the normal branch office approval criteria and procedures under 12 C.F.R. § 545.92 including any public notice and protest procedures would not be applicable since the office location is not being established under § 5 of the HOLA but rather is being authorized as part of the issuance of a new charter under § 406 of the NHA by the FSLIC in supervisory transactions designed to resolve the insolvency of four institutions. We note that the grant of a new office location to such a newly chartered association under § 406 could also be viewed as a form of assistance the FSLIC is authorized to grant in connection with issuing such a charter under the FSLIC's broad authority under § 406 to grant assistance to failing institutions.

E. Post-Conversion Acquisition Issues

Pursuant to Section 563b.10(c)(2), an insured institution that qualifies for a voluntary supervisory conversion receives Section 563b.3(i)(3) anti-takeover protection for up to three years depending on its asset size. While this protection is usually not afforded in FSLIC assisted cases, the Applicant has negotiated for such protection for a period of 12 months. Such time periods is commensurate with the period available under § 563b.10(c)(2) for converting institutions of this size of those involved in this transaction. We believe that such a grant is within the Board's discretionary power.

F. Management Interlocks and CRA

Mr. Simon W. Casady sits on the board of Statesman and is also chairman of the Executive Committee of First Interstate of Iowa and First Interstate Bank of Des Moines, N.A. By virtue of Statesman becoming a holding company of the Institution, and because once chartered such Institution will be authorized to branch in or have its home office in Des Moines, a management interlock issue will arise pursuant to the Depository Institution Management Interlocks Act. Specifically, such common directorships would be prohibited by Section 563f of the Regulations for Insurance of Accounts. However,

since "but for" the acquisition Mr. Casady would not be subject to such regulation, in our opinion, the Board may invoke Section 408(m) to waive the applicable interlock prohibitions.

The application presents no other management interlock issues under either the Management Interlocks Act, 12 U.S.C. ch. 33, or the NHA, 12 U.S.C. § 1730(a)(i). We defer to ORPOS to advise the Board as to whether the Institution is in compliance with the CRA.

G. Taxes and Accounting

The Applicant has requested a certification by the Board based on the grounds set forth at 12 C.F.R. §§ 1464(d)(6)(A)(i), (ii), (iii). We have no objection to the grant of such certification.

The Applicant has not submitted an opinion of tax counsel addressing the tax consequences of the transaction. We recommend that any approval of the subject application be conditioned upon receipt by the Board, prior to consummation of the transaction, of an opinion of counsel that provides that the proposed merger and acquisition of the Institution will not result in any significant tax liability to the Institution.

H. Employment Contracts, Advisory Directors, and Fees

The Application presents no issues regarding employment contracts, advisory directors, or fees.

CORPORATE AND SECURITIES DIVISION STAFF CONTACT: Eric E. Berg
EXTENSION: 6464

Gregory Brett Smith
Deputy Director for
Supervisory Transactions
Corporate and Securities
Division

I concur:

V. Gerard Comizio
Director
Corporate and Securities
Division

Julie L. Williams
Deputy General Counsel

Attachment "A"

Securities Affiliate Conditions

Activities conducted by a "securities affiliate" of the Acquiror shall be conducted in accordance with the following conditions:

(1) The securities affiliate shall be operated in such a manner that maintains its separate corporate identity;

(2) The activities of the securities affiliate shall be conducted in areas that are identifiable and physically distinct from areas where the insured institution controlled by Acquiror conducts the business of receiving deposits;

(3) Insured institutions that are controlled by Acquiror and any securities affiliate shall take measures necessary to ensure that officers, directors and employees of such insured institution who are also officers, directors or employees of any such securities affiliate are aware of and undertake to abide by Federal Home Loan Bank Board policy statements on conflicts of interest, 12 C.F.R. § 571.7, and usurpation of corporate opportunities, 12 C.F.R. § 571.9, and any additional or successor statements of policy or rules addressing these subjects;

(4) Any employee of a securities affiliate that is also an employee of any insured institution controlled by Acquiror that deals with customers at a teller window or comparable area may not receive commissions or other compensation related to the volume of sales of securities by the securities affiliate and any such employee that deals with customers at a teller window or comparable area in connection with services or investments offered by the insured institution shall not also deal with customers in connection with products or services offered by any securities affiliate;

(5) Advertising for the securities affiliate's products and services shall clearly and

2

prominently distinguish such products and services and the operation of such securities affiliate from the operation of any insured institution controlled by Acquiror;

(6) The securities affiliate shall conduct its operation independent from insured institution controlled by Acquiror, pursuant to separate and independent policies and procedures, and any insured institution controlled by Acquiror shall conduct its operations independent from the securities affiliate, pursuant to separate and independent policies and procedures;

(7) Acquiror, any securities affiliate and any insured institution controlled by Acquiror shall take measures necessary to make customers aware that (a) the securities affiliate is a separate organization from the insured institution and (b) in the case of investments recommended, offered, or sold by the securities affiliate that are not insured by the FSLIC or the FDIC, not guaranteed by the insured institution and are not otherwise obligations of the insured institution, that such investments are not obligations of the insured institution and not so insured or guaranteed; and

(8) All transactions between any insured institution controlled by Acquiror and the securities affiliate, including where the insured institution acts in a fiduciary or co-fiduciary capacity in securities transactions through the insured institution's trust department, shall be on terms that are demonstrably comparable to available alternative transactions with unrelated parties.

In addition, with respect to any securities affiliate of the Acquiror that is engaged in the business of underwriting, distributing, or dealing in securities of any type, for a period of 180 days after the Acquiror's acquisition of an insured institution such insured institution shall not, without obtaining prior written approval of the Principal Supervisory Agent, directly or indirectly:

(A) extend credit in any manner to a securities affiliate or a subsidiary thereof,

(B) purchase for its own account assets of a securities affiliate or a subsidiary thereof,

(C) issue a guarantee, acceptance, or letter of credit, including an endorsement of standby

letter of credit, for the benefit of a securities affiliate or a subsidiary thereof, or

(D) extend credit in any manner to any investment company advised by or the shares of which are distributed by a securities affiliate.

(E) extend credit, or issue or enter into a standby letter of credit, asset purchase agreement, indemnity, guarantee, insurance, or other facility, for the purpose of enhancing the marketability of a securities issue underwritten or distributed by a securities affiliate. Provided, however that the foregoing shall not preclude loans in the ordinary course of business.

(F) knowingly extend or arrange for the extension of credit, directly or indirectly, secured by or for the purpose of purchasing any security while, or for thirty days after, that security is the subject of a distribution in which a securities affiliate of that insured bank or insured institution participate as an underwriter or a member of a selling group.

(G) extend credit to an issuer of securities underwritten by a securities affiliate for the purpose of paying the principal of those securities or interest for dividends on those securities.

Provided, however, that subparagraphs (A) and (B) above do not apply to any extension of credit by an insured bank or insured institution made to acquire or sell any securities of the United States if (i) the extension of credit is to be repaid on the same calendar day, (ii) the extension of credit is incidental to the clearing of transactions in those securities through that insured bank or insured institution, and (iii) both the principal of and the interest on the extension of credit are fully secured by securities of the United States.

For the purpose of the foregoing a "securities affiliate" means a company that engages in securities brokerage, investment advisory or other activities permitted for brokers or dealers registered under the Securities Exchange Act of 1934 or for investment advisors registered under the Investment Advisors Act of 1940, underwriting, distributing or dealing in securities of any type, except that such term shall not include insurance products deemed to be securities, including and without limitation variable annuities and variable life insurance.

Ex. "A"

U.S. Department of Justice
Antitrust Division

Judiciary Center Building
555 Fourth Street, N.W.
Washington, D.C. 20001

DJR:BO:DML
60-6120-0064

February 12, 1988

Honorable M. Danny Wall
Chairman
Federal Home Loan Bank Board
1700 G Street, N.W.
Washington, D.C. 20552

Dear Mr. Chairman:

This is in response to your letter of February 3, 1988, requesting a report pursuant to Section 408(e)(2) of the National Housing Act, as amended (12 U.S.C. 1730a(e)(2)), on the competitive factors involved in the proposed acquisition of First Federated Savings Bank of West Palm Beach, West Palm Beach, Florida, First Federal Savings Bank of Waterloo, Waterloo, Iowa, Peoples Federal Savings and Loan Association of Waterloo, Waterloo, Iowa, and Perpetual Savings and Loan Association, Waterloo, Iowa, by The Statesman Group, Inc., Des Moines, Iowa.

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

Sincerely yours,

Donald J. Russell

Donald J. Russell
Assistant Chief
Communications and Finance
Section

84-991 (132)